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No.....

IN THE

Supreme Court of The United States

OCTOBER TERM, 1982

IN THE MATTER OF GARY AIRCRAFT CORPORATION,
Debtor.

GENERAL DYNAMICS CORPORATION,
Petitioner,

v.

GARY AIRCRAFT CORPORATION,
Respondent.

On Writ of Certiorari To The
United States Court of Appeals
For the Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Federal Aviation Act, 49 U.S.C. §§ 1401, *et seq.* assigns priorities to instruments involving title to aircraft, thereby preempting "buyer in the ordinary course of business" provisions of the Uniform Commercial Code as enacted in Texas?

LISTING OF PARTIES

All of the parties in the United States Court of Appeals for the Fifth Circuit are listed in the caption, with the exception of the Victoria Bank and Trust Company which asserts an interest in property which is the subject of these proceedings. Pursuant to Supreme Court Rule 28.1, Petitioner lists the following of its subsidiaries which are not wholly owned: Etudes Techniques et Constructions, Aérospatiales Société Anonyme, Mansour-General Dynamics Ltd, and Mines SNA Inc./SNA Mines Inc.

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On Writ of Certiorari To The
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For The Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in *Gary Aircraft Corporation v. General Dynamics Corporation* (No. 81-1378, *In the Matter of Gary Aircraft Corporation).*

OPINIONS BELOW

The opinion of the court of appeals (App. A., *infra*, 1a-21a) is reported at 681 F.2d 365. The opinion of the district court (App. B, *infra*, 22a-32a) is not reported. The opinion of the bankruptcy court (App. C, *infra*, 33a-39a) is not reported.

JURISDICTIONAL STATEMENT

The opinion and judgment of the court of appeals from which this petition is brought was issued on July 28, 1982. No rehearing was sought, and no extension of time for the filing of this petition has been sought. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. U.S. CONST., art. VI, cl. 2

   > This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; . . . , shall be the supreme law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or laws of any State to the contrary notwithstanding.

2. 49 U.S.C. §§ 1302, 1403, 1406 (App. D, *infra*, 40a-46a). TEX BUS. & COMM. CODE. ANN., §§ 1.201, 9.307 (Vernon Supp. 1982) (App. E, *infra*, 47a-48a).

STATEMENT OF THE CASE

This action concerns the priorities under the Federal Aviation Act, 49 U.S.C. §§ 1401, *et seq.*, and under state law, between a prior security holder, Petitioner, and a subsequent buyer in the ordinary course of business, Respondent. Petitioner, General Dynamics Corporation, and Respondent, Gary Aircraft Cor-

poration, dispute who has the right to $250,000.00 plus interest from the sale of an airplane and the right to title of another aircraft hull.

This case has its beginnings on February 20, 1969, when Frederick B. Ayer & Associates, Inc. executed and delivered to Petitioner an Aircraft Mortgage, granting Petitioner a security interest in two Douglas DC-6B airplanes, bearing FAA Registration Numbers N8221H and N8222H. Petitioner recorded its Aircraft Mortgage with the FAA Aircraft Registry in Oklahoma City, Oklahoma on March 3, 1969, complying in all respects with 49 U.S.C. § 1403. Upon the filing of the Aircraft Mortgage, Petitioner held a perfected security interest in Airplanes N8221H and N8222H.

On December 22, 1971 and January 4, 1972, Respondent's founder, Arthur W. Stewart, purchased in his own name Airplanes N8221H and N8222H from Ayer & Associates. At the same time Respondent requested a title search by telephone with the Aircraft Owners and Pilots Association, which search was reported to Respondent by Reports of Title Search dated January 5, 1972, at 7:59 a.m. The search disclosed Petitioner's Aircraft Mortgage covering the two subject aircraft.

On March 12, 1974 and November 7, 1975, Stewart transferred title to Airplanes N8221H and N8222H to Respondent. The Victoria Bank and Trust Company recorded mortgages upon the two subject aircraft on November 13, 1975. Subsequently on October 28, 1976, Respondent initiated bankruptcy proceedings under Chapter XI of the Bankruptcy Act. On April 25, 1978, Respondent filed a complaint in the United States Bankruptcy Court for the Western District of Texas to sell Airplane N8222H free and clear of liens. Pursuant to bankruptcy court order, Airplane N8222H was sold for the sum of $250,000.00, the substantial portion of which was deposited in an interest bearing account on June 1, 1978 where it has remained to date, subject to the claims of Petitioner and the Victoria Bank. The other airplane in controversy remains at Respondent's premises in Hondo, Texas.

The bankruptcy court held that the Federal Aviation Act does not address itself to the resolution of conflicting claims of priority and that in accordance with provisions of the Uniform Commercial Code as enacted in Texas, Respondent was entitled to the proceeds of the sale of Airplane N8222H and to the possession of Airplane N8221H. Affirming the bankruptcy court, the district court held that the Federal Aviation Act, 49 U.S.C. § 1401 *et seq.* does not preempt state substantive law on lien priority. The court of appeals similarly determined that there was no federal preemption of state law and affirmed the judgment of the district court. While other issues were presented to the lower appellate courts for review, the federal preemption question is the sole question before this Court.

REASONS FOR GRANTING THE WRIT

The Federal Aviation Act of 1958, 49 U.S.C. §§ 1401, *et seq.* ("the Act") provides for a comprehensive federal registration system for all instruments affecting the title to civil aircraft in this country. A purchaser or lienholder, by duly complying with federal recordation provisions, perfects an interest upon filing with the FAA registry and is thus protected against subsequent claims. (App. D, *infra,* 43a-46a). The Texas Business and Commerce Code (The Uniform Commercial Code in Texas) provides: "A buyer in the ordinary course of business... takes free and clear of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence". (App. E, *infra,* 47a-48a).

The decision below of the Fifth Circuit denying federal preemption of state law relating to the priority and enforceability of liens, while supported by precedent, is in direct conflict with decisions of the lower federal courts, the Ninth Circuit in *Danning v. Pacific Propeller, Inc. (In re Holiday Airlines Corporation),* 620 F.2d 731 (9th Cir.), *cert. denied,* 449 U.S. 900 (1980), and several state court decisions, including the Supreme Court of California in *Dowell v. Beech Acceptance Corporation,* 3 Cal. 3d 544, 476 P.2d 401, *cert. denied,* 404 U.S. 823 (1971), all of which have held that the provisions of the Act

preempt state laws insofar as they relate to the priority of liens or other instruments affecting title to aircraft.[1]

The practical effect of this lack of judicial uniformity is to lend complete uncertainty to the enforceability of interests in aircraft filed in the single registry maintained by the Secretary of Transportation. This Court has declined for at least a decade to review the question presented; the Congress has failed to act in the interim; and the result has been proliferation of litigation with contradictory holdings by the state and federal courts of this nation. It is appropriate for this Court to decide whether the Act establishes a system of priority affecting title to aircraft which preempts provisions of state law affecting the same subject matter.

THERE IS A CONFLICT IN HOLDINGS AMONG THE UNITED STATES COURTS OF APPEAL AND A STATE COURT OF LAST RESORT

The Federal Aviation Act provides that, "No conveyance or instrument...shall be valid...until such conveyance or other instrument is filed for recordation...," 49 U.S.C. § 1403(c); and that, "Each conveyance or other instrument recorded...shall from the time of its filing for recordation be valid as to all persons without further or other recordation." 49 U.S.C. § 1403(d).

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[1] *Sun Bank v. Snell (In re Cone)*, 11 B.R. 925 (M.D. Fla. 1981); *In re Veterans' Air Express Co., Inc.*, 76 F. Supp. 684 (D.N.J. 1948); *O'Neill v. Barnett Bank of Jacksonville*, 360 So.2d 150 (Fla.Dist.Ct.App. 1978); *International Atlas Services, Inc. v. Twentieth Century Aircraft Company*, 251 Cal.App.2d 434, 59 Cal.Rptr. 495 (1967); *Crescent City Aviation, Inc. v. Beverly Bank*, 219 N.E.2d 446 (Ind.App. 1966); *Pope v. National Aero Finance Co.*, 236 Cal.App.2d 722, 46 Cal.Rptr. 233 (1965); *Continental Radio Co. v. Continental Bank & Trust Co.*, 369 S.W.2d 359 (Tex.Civ.App. —Houston 1963, writ ref'd n.r.e.).

In *Danning v. Pacific Propeller, Inc., supra,* the lower bankruptcy court was required to determine the rights of various claimants to proceeds from the sale of a Lockheed Electra aircraft. Pacific Propeller urged that by reason of its filing notice of its artisan's lien for overhaul work with the FAA facility in Oklahoma City, it held an enforceable lien against the aircraft and was entitled to priority under the Federal Aviation Act. The bankruptcy trustee, Danning, sought to invalidate Pacific Propeller's lien. The Ninth Circuit confirmed the lower courts' conclusion that the non-consensual lien was valid under state law and the notice properly recorded so as to entitle it to priority under the Federal Aviation Act. *Id.* at 732. In reaching its conclusion, the Ninth Circuit did not apply state law affecting priority of interests in the aircraft, but rather looked to state law to determine whether the non-consensual lien was validly created under state law. The Ninth Circuit expressly held:

> The provisions of the Federal Aviation Act preempts State law insofar as they relate to the priority of liens. *State Securities Co. v. Aviation Enterprises, Inc.*, 355 F.2d 225 (10th Cir. 1966); *Pope v. National Aero Finance Co., Inc.*, 236 Cal.App.2d 722, 46 Cal.Rptr. 233 (1965).

Id. at 733.

On the identical question of federal law, the court below relegated its discussion of *Danning v. Pacific Propeller* to a footnote. *Gary Aircraft Corporation v. General Dynamics Corporation,* (App. A, *infra,* 5a-6a). In attempting to explain away the *Danning* decision, the court below stated:

> Indeed, the Pacific Propeller Court proceeded to apply State priority law after concluding that the FAA sought only to provide a central recording system.

Id. This statement is incorrect. Nowhere in its opinion did the *Danning* court apply state priority law. State law was applied only to determine the underlying validity of the lien instrument involved.

The United States Court of Appeals for the Fifth Circuit in its decision below concluded that the Act does not preempt state law insofar as state law assigns priorities to instruments affecting title to aircraft. The Ninth Circuit in *Danning v. Pacific Propeller, Inc.* held that the Act does preempt state law assignment of priorities. The Ninth Circuit's holding is supported by the Supreme Court of California in *Dowell v. Beech Acceptance Corporation.* The conflict in holdings is explicit and direct. The Court should grant a writ of certiorari to resolve this conflict.

THERE IS A CONFLICT IN HOLDINGS BETWEEN AT LEAST TWENTY-EIGHT LOWER AND INTERMEDIATE STATE AND FEDERAL COURTS, AND THE QUESTION PRESENTED IS, ACCORDINGLY, TIMELY AND IMPORTANT

This Court has never ruled on whether the Federal Aviation Act's comprehensive provisions for regulating the conveyancing of aircraft preempt state doctrines of buyer in the ordinary course of business in dealing with priorities between claimants under successive transactions involving the same aircraft. On three occasions in the past decade, however, this Court has had the opportunity, but declined to hear cases presenting this question.[2] In the meantime, there has been an increase of litigation involving interests in aircraft.

In addition to the conflicting results noted above between the Fifth Circuit, the Ninth Circuit and the California Supreme

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[2] *Danning v. Pacific Propeller, Inc. (In re Holiday Airlines)*, 620 F.2d 731 (9th Cir.), *cert. denied*, 449 U.S. 900 (1980) (preemption); *Bank of Hendersonville v. Red Baron Flying Club, Inc.*, 571 S.W.2d 152 (Ct.App.Tenn. 1977), *cert. denied*, 439 U.S. 1089 (1979) (no preemption); *Dowell v. Beech Acceptance Corp.*, 3 Cal.3d 544, 476 P.2d 401 (1970), *cert. denied*, 404 U.S. 823 (1971) (preemption).

Court, Arizona,[3] Arkansas,[4] Florida,[5] Georgia,[6] Illinois,[7] Indiana,[8] Kentucky,[9] Louisiana,[10] Missouri,[11] New Jersey,[12] North Carolina,[13] Oklahoma,[14] Tennessee,[15] and Texas[16] have also reached conflicting results on the coverage of the Act, and whether it grants priority to a security interest recorded under its provisions. Moreover, the United States Courts of Appeals for the Third[17] and Tenth[18] Circuits, as well as numerous federal district and bankruptcy courts[19] have differed not only in result, but also in interpretation and application of the Act.

Given this unwieldy state of law, parties holding security interests in aircraft who have complied in all respects with 49 U.S.C. § 1401 *et seq.*, can have no certainty as to the protection afforded their collateral. In its wisdom Congress established a unique system for streamlining the conveyancing of aircraft and parts. There is one central recording place in the United States which can be checked for disclosure of interests in such property. The continued maintenance of this elaborate, centralized system for the filing and recordation of aircraft conveyances is

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[3] *Lochhead v. G.A.C. Finance Corp.*, 6 Ariz.App. 539, 434 P.2d 655 (Ariz.Ct.App. 1967) (Act preempts field of registration of conveyances).

[4] *American Aviation, Inc. v. Aviation Ins. Managers, Inc.*, 244 Ark. 829, 427 S.W.2d 544 (Ark. 1968) (Congress has preempted field of recordation but left question of validity of the conveyance to state law).

[5] *O'Neill v. Barnett Bank of Jacksonville, N.A.*, 360 So.2d 150 (Fla. Dist.Ct.App. 1978) (Act preempts state "buyer in ordinary course" law).

[6] *Dawson v. General Discount Corp.*, 60 S.E.2d 653 (Ct.App.Ga. 1950) (priority given to party who recorded instrument under Act).

[7] *Bitzer-Croft Motors v. Pioneer Bank & Trust Co.*, 82 Ill.3d 1, 401 N.E.2d 1340 (Ct.App.Ill. 1980) (federally recorded lien not determinative in resolving priority dispute decided under state law).

meaningless if parties are not required to check that file prior to dealing with interests in aircraft. The record here is appropriate for deciding the broad and important federal question involved.

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[8] *Crescent City Aviation, Inc. v. Beverly Bank*, 219 N.E.2d 446 (Ind.App. 1966) (federal preemption of mechanics' lien created under state law).

[9] *Cessna Finance Corp. v. Skyways Enterprises, Inc.*, 23 UCC Rep.Serv. 1015 (Ky.Ct.App. 1978), *aff'd*, 580 S.W.2d 491 (Ky. 1979) (Act does not preempt state "buyer in ordinary course" law).

[10] *Aircraft Investment Corp. v. Fisher Flying Service, Inc.*, 183 So.2d 441 (Ct.App.La. 1966) (Act preempts field of sale and recordation of instruments affecting title or interest to aircraft).

[11] *J.C. Equipment, Inc. v. Sky Aviation, Inc.*, 498 S.W.2d 73 (Mo.Ct.App. 1973) (Congress has preempted field of registering and recording title documents).

[12] *Southern Jersey Airways, Inc. v. National Bank of Secaucus*, 261 A.2d 399 (Super.Ct.N.J. 1970) (federally recorded lien does not preempt state created mechanics' lien; relative priorities of parties determined in accordance with state law).

[13] *Norris v. Insurance Company of North America*, 215 S.E.2d 379 (Ct.App.N.C. 1975) (Act is controlling over state law as to manner in which recordation of conveyances and encumbrances on aircraft are made).

[14] *Catlin Aviation Company v. Equilease Corporation*, 626 P.2d 857 (Okla. 1981) (Act is controlling over state law as to recordation while state law determines inherent validity of conveyance).

[15] *Bank of Hendersonville v. Red Baron Flying Club, Inc.*, 571 S.W.2d 152 (Ct.App.Tenn. 1977), *cert. denied*, 439 U.S. 1089 (1979) (Act does not preempt state "buyer in ordinary course" law).

A ruling from this Court in this case would provide the federal and state courts with authoritative interpretation of 49 U.S.C. §§ 1401, *et seq.* The question presented is a timely and important one on which this Court should rule.

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[16] *Continental Radio Co. v. Continental Bank & Trust Co.*, 369 S.W.2d 359 (Tex.Civ.App.—Houston 1963, writ ref'd n.r.e.) (federal preemption of mechanics' lien created under state constitution).

[17] *Sanders v. M.D. Aircraft Sales, Inc.*, 575 F.2d 1086 (3d Cir. 1978) (Act does not preempt state "buyer in ordinary course" law).

[18] *State Securities Company v. Aviation Enterprises, Inc.*, 355 F.2d 225 (10th Cir. 1966) (federal preemption of state law registration although state law applies to determine validity of title documents).

[19] *See, e.g., Sun Bank v. Snell (In re Cone)*, 11 B.R. 925 (M.D.Fla. 1981) (Act preempts state law relating to priority of liens); *Shacket v. Roger Smith Aircraft Sales*, 497 F.Supp. 1262 (N.D. Ill. 1980) (no federal preemption of state law principles governing priorities); *Haynes v. General Electric Credit Corp.*, 432 F.Supp. 763 (W.D.Va. 1977), *aff'd per curiam*, 582 F.2d 869 (4th Cir. 1978) (no federal preemption of state "buyer in ordinary course" doctrine); *Industrial National Bank v. Butler Aviation International*, 370 F.Supp. 1012 (E.D.N.Y. 1974) (no federal preemption of state possessory lien for storage charges); *In re Veterans' Air Express Co. Inc.*, 76 F.Supp. 684 (D.N.J. 1948) (federal preemption of possessory lien for repair work under state law); *Texas National Bank of Houston v. Aufderheide*, 235 F.Supp. 599 (E.D.Ark. 1964) (Act does not preempt UCC "buyer in ordinary course" law); *Northern Illinois Corp. v. Bishop Distributing Co.*, 284 F.Supp. 121 (W.D.Mich. 1968) (Act does not preempt state "buyer in ordinary course" law).

THE DECISION BELOW IS INCORRECT BECAUSE "BUYER IN THE ORDINARY COURSE OF BUSINESS" PROVISIONS OF TEXAS LAW OBSTRUCT AND FRUSTRATE THE OBJECTIVES AND POLICIES OF THE FEDERAL AVIATION ACT, IN DEROGATION OF THE SUPREMACY CLAUSE OF THE UNITED STATES CONSTITUTION

The Federal Aviation Act unmistakably treats the subject of priorities to instruments involving title to civil aircraft in this country. Section 1403(c) and (f) of the Act state in pertinent part as follows:

> (c) *No conveyance* or instrument the recording of which is provided for by section (a) of this Section *shall be valid* in respect of such aircraft, aircraft engine, or engines, propellers...*against any person...until such conveyance or other instrument is filed for recordation in the office of the Secretary of Transportation.*
>
> (f) *The Secretary of Transportation shall keep a record of the time and date of the filing of conveyances* and other instruments with him and of the time and date of recordation thereof. *He shall record conveyances and other instruments filed with him in the order of their reception*, in files to be kept for that purpose, and indexed according to —
>
> > (1) the identifying description of the aircraft, aircraft engine, or propeller, or in the case of an instrument referred to in subsection (a) (3) of this section, the location or locations specified therein, and
> >
> > (2) the names of the parties to the conveyance or other instrument.

(Emphasis added). Section 1403(d), when read in light of § 1403(c) and (f), above, establishes a priority system:

> (d) Each conveyance or other instrument recorded by means of or under the system provided for in subsection (a) or (b) of this section *shall from the time of its filing for recordation be valid as to all persons without further or other recordation....*

(Emphasis added).

Congress, by requiring the Secretary of Transportation to "record conveyances and other instruments...in the order of their reception" according to "the time and date of the filing" necessarily anticipates reliance on these provisions to establish priority for claimants whose rights to aircraft are dependent upon the fact or time of recordation of conveyances. This federal recording scheme (App. D, *infra,* 43a-46a) is in direct conflict with operative provisions of the Uniform Commercial Code as enacted in Texas (App. E, *infra,* 47a-48a).

The acceptance by the court below of state "buyer in the ordinary course of business" doctrine interferes with legitimate national policy as set forth in the Federal Aviation Act. Specifically, 49 U.S.C. § 1302 requires the Civil Aeronautics Board to consider certain matters "as being in the public interest", which include:

> (a) (5) The development and maintenance of a sound regulatory environment which is responsive to the needs of the public and in which decisions are reached promptly in order to facilitate adaption of the air transportation system to the present and future needs of the domestic and foreign commerce of the United States, the Postal Service, and the national defense.

The superseding of a comprehensive system of centralized recordation by state law neither promotes "a sound regulatory environment" nor facilitates the "needs of the domestic and foreign commerce".

Precisely this type of analysis of the Act's policies and objectives was highlighted in *Dowell v. Beech Acceptance Corp., supra.* In that case, the Supreme Court of California discussed at length these objectives:

> ...To bring order into the field of aircraft ownership and finance, the federal government in a manner within its sphere set up a comprehensive scheme of centralized recordation, which, if properly used, provides adequate protection for all substantial property interests in large aircraft,...
>
> Here we have a complete and comprehensive system of recordation which necessarily supersedes inconsistent state law. Constitutionally, the federal government may be said to have fully occupied the field of recordation of interests in aircraft and of rights derived from recordation, and to have established paramount law in this area...
>
> ...section 1403 provides a comprehensive system of recordation the purpose of which is to bring order to the field of aircraft titles and to protect the holders of substantial property interests in aircraft. Neither of those purposes is served if we apply state law in a manner virtually ignoring the existence of the federal system. If prior recorded interests are not protected against subsequent buyers who fail to search title, the federal policy in favor of the recordation of aircraft titles will be frustrated and subsequent purchasers... will cavalierly decline to investigate title so as to avoid "actual notice" under Commercial Code section 9307.
>
> ...It is clear that the Congress has prescribed the only way in which aircraft may be transferred and in which liens upon aircraft may be duly recorded. In this manner, all persons dealing with aircraft are upon full legal notice concerning possible liens *and are charged with the duty of inquiry at the central recording of-*

> *fice... with respect to any aircraft in which they might be concerned.* (Court's emphasis).
>
> • • • •
>
> *...The federal policy to foster recordation and to protect recorded interests is eviscerated by a rule which relies on state laws to protect the buyer in the ordinary course of business even though he fails to undertake a simple title search which would have readily revealed all encumbrances.*

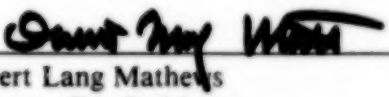
(Emphasis added). *Id.* at 403-406. *See also, In re Veterans' Air Express Co., Inc.*, 76 F.Supp. 684, 686-691 (D.N.J. 1948); *Sun Bank v. Snell (In re Cone)*, 11 B.R. 925, 929-930 (M.D.Fla. 1981).

The Supremacy Clause, U.S. CONST., art. VI, cl. 2, invalidates any exercise of state power that unduly frustrates a federal scheme or obstructs the objectives of legitimate national policy. *Chicago and North Western Transportation Company v. Kalo Brick & Tile Company*, 450 U.S. 311, 316-317 (1981); *Malone v. White Motor Corp.*, 435 U.S. 497, 504 (1978); *Hines v. Davidowitz*, 312 U.S. 52, 67-68 (1941). "Buyer in the ordinary course of business" provisions of the Uniform Commercial Code as enacted in Texas unquestionably frustrate and obstruct the Federal Aviation Act and should be preempted by the Supremacy Clause of the United States Constitution.

CONCLUSION

Since the denial of writ of certiorari in the decision of *Dowell v. Beech Acceptance Corp.*, there have been more than twenty-eight decisions on variations of the question presented. There is no uniform law of the land. This Court should grant the petition for writ of certiorari in this case to resolve the conflicting lines of reasoning, to give predictability to rights of ownership in aircraft, and to uphold the supremacy of law enacted by the Congress of the United States.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that on the 26th day of September, 1982, true and correct copies of the foregoing Petition for Writ of Certiorari were served upon the attorneys of record for Gary Aircraft Corporation and Victoria Bank & Trust Company by depositing the same in the United States Mail, first-class postage prepaid, certified, return receipt requested, addressed as follows:

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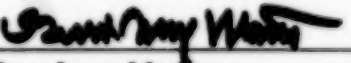

Gilbert Lang Mathews

APPENDIX A

IN THE MATTER OF GARY AIRCRAFT CORPORATION,
Debtor.

GARY AIRCRAFT CORPORATION,
Plaintiff-Appellee,

VS.

GENERAL DYNAMICS CORPORATION,
Defendant-Appellant.

No. 81-1378.

United States Court of Appeals,
Fifth Circuit.

July 28, 1982.

Appeal from the United States District Court for the Western District of Texas.

Before WISDOM, POLITZ and TATE, Circuit Judges.

WISDOM, Circuit Judge:

I.

This dispute over the ownership of one airplane and of the proceeds of the sale of another requires us to determine the reach of the Federal Aviation Act and its impact on state law. We also explore the protection accorded buyers against secured creditors by state law.

In December 1971, Gary Aircraft Corporation ("Gary"), the plaintiff-appellee, entered into a letter of understanding stating its intention to purchase four airplanes from Frederick B. Ayer & Associates, Inc. ("Ayer"), a dealer in aircraft. Two of these airplanes are the subject of the controversy here. Gary did not complete the purchase, but Arthur Stewart, its president, carried out the transaction in his individual capacity, purchasing the first plane in controversy here, N8222H, on December 22,

1971 for $5,000, and the second, N8221H, on January 4, 1972, also for $5,000. On the date of each sale, the airplane purchased was subject to a security interest held by General Dynamics Corporation ("General Dynamics"), the defendant-appellant. General Dynamics held its interest under a security agreement executed by Ayer on February 20, 1969. Under that agreement, Ayer was authorized to sell the collateral, unless it was in default on its obligations to General Dynamics. In case of default, Ayer could not sell without the written consent of General Dynamics. General Dynamics recorded its security agreement with the Federal Aviation Administration on March 3, 1969. On the dates of the sales to Stewart, Ayer was in default.[1]

Crawford, the vice-president of Gary, requested a title search from the Aircraft Owners and Pilots Association on January 4, 1972. The AOPA reported the results on January 5, 1972. On August 3, 1972, approximately seven months after the sale, Stewart recorded his bill of sale with the FAA. Over the next four years, Crawford communicated periodically with Ayer, requesting that Ayer take action to secure the release of General Dynamic's security interest.

In March 1974, Stewart sold one of the group of four planes to Gary for $13,275. He transferred the two planes at issue here to Gary on November 7, 1975, apparently without consideration. Gary executed a mortgage on the aircraft in favor of the Victoria Bank and Trust Company, the third party defendant. The Victoria Bank recorded its interest with the FAA. On May 28, 1976, General Dynamics informed Gary that it had learned that the aircraft were registered in Gary's name and that General Dynamics was asserting a security interest in the property.

On October 28, 1976, Gary initiated Chapter XI proceedings under the Bankruptcy Act. It brought this action in the bankruptcy court, seeking to sell Airplane N8222H free and clear of

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[1] There is some dispute as to whether the parties have stipulated that the sale was unauthorized. We will assume, for purposes of this appeal, that Ayer was in default and that the sale was unauthorized.

liens. Upon the agreement of all interested parties, the court permitted the sale of the airplane, and the proceeds were deposited with the court. The second airplane remains in the possession of Gary.

The bankruptcy court, affirmed by the district court, held that Gary was entitled to the proceeds of the sale of Airplane N8222H and to the possession of Airplane N8221H, free of any interest asserted by General Dynamics. General Dynamics appeals, presenting three theories. First, it contends that the Federal Aviation Act grants it priority because it recorded its security interest with the Federal Aviation Administration before Stewart purchased the aircraft. Second, even if the FAA does not govern the priority question but instead remits it to Texas law, which protects a buyer in the ordinary course of business against the perfected security interest of his seller's creditor, General Dynamics argues that Stewart could not take free of its interest because, according to General Dynamics, Stewart could not qualify as a buyer in the ordinary course of business. Finally, General Dynamics contends that, even if Stewart did qualify as a buyer in the ordinary course, he could not transfer his status to Gary, and Gary did not qualify in its own right so, in Gary's hands, the aircraft are subject to the interest of General Dynamics. Concluding that the FAA does not govern priorities in interests in aircraft, that Stewart, as a buyer in the ordinary course of business, took free of General Dynamics's interest, and that Gary takes the title of its transferor, we affirm.

II.

General Dynamics's first theory presents this court, for the first time, with the question to what extent the provisions of the Federal Aviation Act, 49 U.S.C. §§ 1301-1542, preempt state regulation of interests in aircraft. The Civil Aeronautics Act of 1938, and its successor, the Federal Aviation Act of 1958, both create a single national recording system for interests in aircraft. Section 503 of the FAA, 49 U.S.C. § 1403, establishes the recording system and provides,

> (c) No conveyance or instrument the recording of which is provided for by subsection (a) of this section shall be valid in respect of such aircraft . . . against any person other than the person by whom the conveyance or other instrument is made or given, his heir or devisee, or any person having actual notice thereof, until such conveyance or other instrument is filed for recordation . . .
>
> (d) Each conveyance or other instrument recorded by means of or under the system provided for in subsection (a) or (b) of this section shall from the time of its filing for recordation be valid as to all persons without further or other recordation.[2]

In 1964, Congress added section 506, 49 U.S.C. § 1406, providing,

> The validity of any instrument the recording of which is provided for by section 1403 of this title shall be governed by the laws of the State, District of Columbia, or territory or possession of the United States in which such instrument is delivered. . . .

Without question, section 506 reserves some areas of regulation for the states by assigning questions of "validity" to state law. At the same time, Congress has provided the exclusive means of recordation and has preempted state laws providing filing systems for interests in aircraft. *See, e.g., Bank of Lexington v. Jack Adams Aircraft Sales, Inc.*, 5 Cir. 1978, 570 F.2d 1220 (dictum); Scott, *Liens in Aircraft: Priorities*, 25 J.Air L. & Com. 193, 200 (1958).

Whether Congress intended to preempt a broader field of state law by federalizing also the assignment of priorities to various interests in aircraft is not as clear. The courts have split

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[2] In this respect, the Federal Aviation Act reenacted the Civil Aeronautics Act without substantial change. The legislative history makes clear, however, that the re-enactment is not to be taken as an endorsement of any judicial construction of the CAA. *See* H.R.Rep.No. 2360, 85th cong., 2d Sess. (1958), *reprinted in* [1958] U.S.Code Cong. & Ad.News 3741, 3750.

on that question. *Compare e.g., Sun Bank v. Snell (In re Cone),* Bkrtcy.M.D.Fla.1981, 11 B.R. 925 (FAA preempts state priorities law); *Dowell v. Beech Acceptance Corp.,* 1970, 3 Cal.3d 544, 476 P.2d 401, 91 Cal.Rptr. 1 (in banc) (same), *cert. denied,* 1971, 404 U.S. 823, 92 S.Ct. 45, 30 L.Ed.2d 50; *and O'Neill v. Barnett Bank,* Fla.App.1978, 360 So.2d 150 (same) *with, e.g., Danning v. World Airways, Inc. (In re Holiday Airlines),* 9 Cir.1981, 647 F.2d 977 (FAA does not preempt state priorities law), *cert. denied,* 1982, — U.S. —, 102 S.Ct. 1009, 71 L.Ed.2d 299; *Sanders v. M.D. Aircraft Sales, Inc.,* 3 Cir. 1978, 575 F.2d 1086 (same); *Bitzer-Croft Motors v. Pioneer Bank & Trust Co.,* 1980, 82 Ill.App.3d 1, 37 Ill.Dec. 247, 401 N.E.2d 1340 (same); *and Southern Jersey Airways, Inc. v. National Bank,* 1970, 108 N.J.Super 369, 261 A.2d 399 (same). After considering the language of the FAA and the CAA as well as their legislative history, we conclude that the FAA does not displace state law assignment of priorities to interests in aircraft. That conclusion is in accord with the weight of recent authority, *see* cases cited above; *CIM International v. United States,* 9 Cir.1980, 641 F.2d 671, 675 n.6; *Danning v. Pacific Propeller, Inc. (In re Holiday Airlines Corp.),* 9 Cir.1980, 620 F.2d 731, *cert. denied,* 449 U.S. 900, 101 S.Ct. 269, 66 L.Ed.2d 130; *Haynes v. General Electric Credit Corp.,* W.D.Va.1977, 432 F.Supp. 763; *Industrial National Bank v. Butler Aviation International, Inc.,* E.D.N.Y.1974, 370 F.Supp. 1012, 1016-17; *Cessna Finance Corp. v. Skyways Enterprises, Inc.,* Ky.1979, 580 S.W.2d 491.[3] A majority of the commentators agree. *See* 1

[3] Given the large number of cases on this point — some three dozen as of 1973, *see* Sigman, *The Wild Blue Yonder: Interests in Aircraft Under Our Federal System,* 46 S.Cal.L. Rev. 316, 317 n.6 (1973) — it would not be profitable to engage in lengthy examination of the facts of prior cases or in an evaluation of the reasons relied upon in each case reaching a result different from ours. Such exegesis is available elsewhere. *See id.* at 338-76; Annot., 22 A.L.R.3d 1270 (1968 & Supp.1981). It is, however, worth noting that the only recent federal case we have found that holds state priorities law preempted, *Sun Bank v. Snell (In re Cone),* Bkrtcy.M.D.Fla.1981, 11 B.R. 925, did not examine the legislative history but simply asserted that the FAA preempted priority rules. The single federal case it offered as authority was *Danning v. Pacific Propeller, Inc. (In re Holiday Airlines Corp.),* 9 Cir. 1980, 620 F.2d 731, *cert. denied,* 449 U.S. 900, 101 S.Ct. 269, 66 L.Ed. 2d 130, which did state "The provisions of the Federal Aviation Act preempt

G. Gilmore, Security Interests in Personal Property § 13.5 (1965); J. White & R. Summers, Uniform Commercial Code § 25-16 at 1077 (2d ed. 1980); Sigman, *The Wild Blue Yonder: Interests in Aircraft Under Our Federal System,* 46 S.Cal.L.Rev. 316 (1973); Note, *Taking the Lender for a Ride: Section 1403 of the Federal Aviation Act and the Buyer in the Ordinary Course of Business,* 36 Wash. & Lee L.Rev. 205 (1979); Note, *Federal Protection of Security Interests in Carriers' Mobile Equipment,* 71 Harv.L.Rev. 1516, 1530-31 (1958).

Although Congress has acted in the general field of aircraft interests, the supremacy clause, U.S.Const. art. VI, requires us to invalidate[4] state law only if it conflicts with a federal statute, if it would frustrate a federal scheme, or if the totality of the circumstances shows that Congress sought to occupy the field. The

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state law insofar as they relate to the priority of liens." *Id.* at 733. But that statement simply repeats the truism that, *to the extent* that federal law deals with priorities, it preempts state law. Indeed, the *Pacific Propeller* court proceeded to apply state priority law after concluding that the FAA sought only to provide a central recording system, *see id.* at 733, 735-36. The Ninth Circuit has relied on *Pacific Propeller* as authority for the proposition that the FAA does not preempt state law on priorities, *CIM International v. United States,* 9 Cir. 1980, 641 F.2d 671, 675 n.6, and has recently re-stated that proposition without seeing any need to explain *Pacific Propeller, Danning v. World Airways, Inc. (In re Holiday Airlines),* 9 Cir., 1981, 647 F.2d 977, *cert. denied,* 1982, — U.S. —, 102 S.Ct. 1009, 71 L.Ed.2d 299. Consequently, we think that *Sun Bank* is without foundation.

In this case, we would not have to *invalidate* state law, for chapter 9 of the Texas Business and Commerce Code, which is the applicable state law, does not apply "to a security interest subject to any statute of the United States . . . to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property". Tex.Bus. & Comm.Code Ann. § 9.104(1) (Vernon Supp.1982). Thus, if we hold that Congress intended to govern the rights of third parties, the Texas statute by its own terms does not apply, and we need not invalidate it. Nonetheless, to determine whether chapter 9 applies, we must engage in the analysis ordinarily applied to questions of preemption.

intent of Congress is determinative.[5] *Malone v. White Motor Corp.*, 1978, 435 U.S. 497, 504, 98 S.Ct. 1185, 1189, 55 L.Ed.2d 443, 450. The courts do not favor the preemption of state law, however, and, in the absence of strong reasons to believe that Congress intended to displace it, state law governs. *Chicago and Northwestern Transportation Co. v. Kalo Brick & Tile Co.*, 1981, 450 U.S. 311, 315-316, 101 S.Ct. 1124, 1129, 67 L.Ed.2d 258, 264-65.

Before examining the statute itself, we reject General Dynamics's contention that it would be meaningless to create a central recording system without according priority to earlier recorded interests.[6] Refusing to grant priority to recorded interests over all others would make sense if Congress were attempting to deal with the problems created by the mobility of

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[5] The early leading case holding that the CAA preempted state law did not undertake an examination of legislative intent. *In re Veterans' Air Express Co.*, D.N.J.1948, 76 F.Supp. 684. Instead, the court established a proposition now indubitably true — that Congress had the power, under the commerce clause, to regulate the aircraft in question, even though they were not at that time mobile in interstate commerce. Then, the *Veterans'* court apparently assumed that Congress had exercised that power to displace state law. (The holder of the mortgage interest in the case was the federal government, and, in the words of one court, the *Veterans'* analysis is "beclouded by allusions to priority of government-owned liens". *Southern Jersey Airways, Inc. v. National Bank*, 1970, 108 N.J.Super. 369, 261 A.2d 399.) The failure to analyze the key question of congressional intent diminishes the value of the *Veterans'* decision, just as it diminishes the value of *Dawson v. Gen. Discount Corp*, 1950, 82 Ga.App. 29, 60 S.E.2d 653, and thus undermines later cases that rely on these opinions. Similarly, the foremost recent cases holding that the FAA preempts state law fail to cite anything in the legislative history or even to point to statutory language that supports the asserted intention of Congress to protect recorded interests against all other interests. *See Sun Bank v. Snell (In re Cone)*, M.D.Fla.1981, 11 Bankr.925; *Dowell v. Beech Acceptance Corp.*, 1970, 3 Cal.3d 544, 476 P.2d 401, 91 Cal.Rptr. 1 (in bank), *cert. denied*, 1971, 404 U.S. 823, 92 S.Ct. 45, 30 L.Ed.2d 50; *O'Neill v. Barnett Bank*, Fla. App.1978, 360 So.2d 150.

[6] In *Bank of Lexington v. Jack Adams Aircraft Sales, Inc.*, 5 Cir.1978, 570 F.2d 1220, 1225, this court suggested that the FAA did not necessarily occupy the field as General Dynamics's argument would suggest. There the court stated, "The [Federal Aviation] Act preempts *only* that portion of state law which *conflicts* with its provisions." (emphasis added).

aircraft. Before the enactment of the CAA, to be certain of protecting his interest insofar as an interest in an airplane was protectible by recordation, the holder had to record in all states in which the aircraft might be located. Similarly, a subsequent creditor or purchaser had to undertake a title search in all states if he wished to be certain that no prior recorded interests existed. By creating a single federal recording system, Congress eliminated the need for multiple recordation and multiple title searches. If that was the only problem that Congress intended to resolve, it would not be necessary to address the question of priorities at all, for the establishment of a recording system does not compel any given set of priority rules. The Uniform Commercial Code is a case in point. Although it sets up a recording system for interests in personal property, *see* U.C.C. §§ 9-401-9-403 (1962), it also creates a priority system under which a recorded interest does not take precedence over all unrecorded interests or all interests recorded later, *e.g.*, *id.* §§ 9-307(2), 9-310. These special priority rules further goals other than encouraging recordation, such as promoting the free alienability of goods by protecting good faith buyers from the interests of the creditors of their retailer-sellers. In enacting the CAA and the FAA, Congress could have intended to eliminate the problems inherent in local recordation of mobile property but to leave to the states the task of striking the balance between competing interests that dictates the effect that recordation of an interest will have on its priority.

Looking to the statute itself, we find that the language is ambiguous. Subsections 503(c) and (d) provide that no instrument shall be "valid" (except against the parties to the instrument and parties with actual knowledge) until filed and that, once filed with the Federal Aviation Administration, all instruments shall be "valid" without further recordation. But "validity" need not establish priority. On the contrary, it may mean nothing more than that recordation with the FAA will assure the instrument such "validity" as state law grants a recorded instrument. As the district court noted, if the term "valid" refers to enforceability, a literal interpretation of the language would lead to irrational results — one could create an enforceable interest in an aircraft without giving any value simply by record-

ing it with the FAA.[7] Still, we could read the statute as giving "validity" in the sense of priority to recorded interests *otherwise* "valid" under state law — that is, "valid" in the sense of complying with formalities and requirements of consideration. Under that interpretation, the choice of law rule in section 506, which refers questions of "validity" to the law of the state where the instrument was delivered, would mean only that the law of that state governs these questions of formality and adequacy of consideration.

The statute does undertake to assign some substantive priorities. For instance, it recognizes and provides for recordation of the "basket lien" — a lien over stocks of spare parts maintained for installation in aircraft, 49 U.S.C. § 1403(a)(3) — and provides that a recorded interest in a specific engine shall have priority over both previously and subsequently recorded basket liens. § 1403(d). *See* 1. G. Gilmore, Security Interests in Personal Property § 13.5 (1965). But the treatment of this special lien, *see id.*, does not necessarily indicate that Congress was legislating a full set of priority rules to cover all interests. On the contrary, the use of specific language to cover this special case could just as readily suggest that Congress meant to leave other priority rules remain unchanged — that is, they are left to state law.[8]

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[7] In fact, the provisions of section 503 never state that recorded interests will take priority over interests recorded subsequently. Instead, section 503 makes *every* recorded interest "valid" against *all* persons; if "valid" means "enforceable", section 503 makes all recorded interests enforceable against all other recorded interests — a logical impossibility for a priority system. Only by assuming the conclusion can one make section 503 a system according priority to recorded interests in order of time of filing.

[8] Similarly, section 503(c) of the Act, 49 U.S.C. 1403(c), states that, until recordation, an instrument shall not be valid except as to the parties and their successors and persons with actual knowledge. That provision could be read as providing a priority rule for persons with actual knowledge. It could, however, also, be read as treating the instrument as recorded as to the party with actual knowledge and leaving the question of the effect of that constructive recordation to state law.

It is also instructive to compare the language and structure of the FAA with that of the Ship Mortgage Act, 46 U.S.C. §§ 911-984. In the SMA, Congress used language very similar to section 503 of the FAA, stating,

> (a) No sale, conveyance, or mortgage which, at the time such sale, conveyance, or mortgage is made, includes a vessel of the United States, or any portion thereof, as the whole or any part of the property sold, conveyed, or mortgaged shall be valid, in respect to such vessel, against any person other than the grantor or mortgagor, his heir or devisee, and a person having actual notice thereof, until such bill of sale, conveyance, or mortgage is recorded in the office of the collector of customs of the port of documentation of such vessel, as provided in subsection (1) of this section.

46 U.S.C. § 921(a). Then, the Act defines the "preferred mortgage" as a mortgage on an entire vessel that meets certain other requirements. *Id.*, § 922. In section 953(b), the SMA specifies the priority accorded the preferred mortgage in a judicial sale: it prevails over all interests except costs allowed by the court and "preferred maritime liens" (defined as liens arising prior in time to the recording of the preferred mortgage), liens for tort damages, and liens for wages of a stevedore, § 953(a). Also, the preferred mortgage prevails over common law possessory liens, such as a mechanic's lien. §§ 952, 953(b). If the language of section 921 sufficed to create a priority system, as General Dynamics urges that the similar language of the FAA does, it is difficult to see why Congress bothered to specify that preferred maritime liens prevailed over the preferred mortgage, for, if there is a priority system implicit in section 921, *see* note 6, it already gives the earlier interest priority. Similarly, it should have been unnecessary to grant the preferred mortgage priority over a possessory lien, for such unrecorded liens would not be enforceable against third parties if section 921 created a priority system.

Thus, though Congress has not spoken with the pristine clarity desirable to a judiciary charged with the task of divining the meaning of some Delphic congressional enactments, our examination of the language of the FAA favors construing it as the creation of a central recording system and not as an attempt to assign priorities to competing interests in aircraft. The legislative history also supports that view.

The history of the FAA itself provides no guidance, for Congress there simply re-enacted these provisions of the CAA without substantial change. *See* note 1. The history of the CAA, though, reflects the original consideration Congress gave to this legislation. Nowhere does it indicate an attempt to deal with the problem of priorities. *See* H.R.Rep.No.2254, 75th Cong., 3d Sess. (1938); S.Rep.No.1661, 75th Cong., 3d Sess. (1938); H.R.Rep.No.2635, 75th Cong., 3d Sess. (1938) (Conference Report).[9] In fact, the Senate version of the bill was amended to delete language that would have created substantive priority rules. 83 Cong.Rec.6757 (1938). In sum, the legislative history suggests that the main concern of Congress was to create a central filing system, leaving the effect of filing to the states. Consequently, we conclude that the FAA does not preempt state law

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[9] A later Congress, explaining the need for section 506, indicated that it viewed the statute as creating only a recording system and compared it to the Federal Motor Vehicle Lien Act, Pub.L. No.85-728 (repealed 1978), which dealt with security interests in certain large buses and trucks by making enforceable in all states a security interest validated in one state. H.R. Rep.No.1033, 88th Cong., 1st Sess. 2-3 (1963). Under the FMVLA, as one commentator put it

> It is too clear for argument that the law applicable to security transactions which may be perfected under 49 U.S.C. § 313 is the law of some state and is not federal law.... It is improbable that 49 U.S.C. § 313 will ever pose any difficult problems in litigation. It is certain that it provides not even a handhold for argument that the law of motor vehicle liens has become federal law.

I. G. Gilmore, Security Interest in Personal Property § 13.7 (1965). Of course, the view of a later Congress does not establish the intent of the enacting Congress. Nonetheless, it does help to confirm our conclusion as would opinions of other courts examining legislative intent.

on priorities.[10] Our conclusion does not, however, resolve this case, for General Dynamics insists that it prevails even if Texas law governs the priority of interests.

III.

Under the Uniform Commercial Code, enacted as the Texas Business and Commerce Code, a buyer in the ordinary course of business is one who, in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party, buys from a person in the business of selling goods of that kind. Tex.Bus. & Com.Code Ann. § 1.201(9) (Vernon Supp.1982). Such a buyer takes free of a security interest created by his seller, even if that interest is perfected and even if the buyer knows of its existence. *Id.*, § 9.307(a).

Since Gary claims its title through Stewart, it cannot hold the aircraft and the proceeds free of General Dynamics's lien unless Stewart held the aircraft free of the lien, as a buyer in the ordinary course of business under section 9.307(a). General Dynamics offers three arguments that it contends require reversal of the holding that Stewart qualified as a buyer in the ordinary course of business.

First, General Dynamics contends that the bankruptcy court misapplied the burden of proof. The burden on this issue does rest with the party claiming the status of a buyer in the ordinary course of business, as General Dynamics urges. *See International Harvester Co. v. Glendenning*, Tex.Civ.App. — Dallas 1974, 505 S.W.2d 320, 324. Nonetheless, General Dynamics cannot prevail on this argument, for we agree with the district

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[10] We also reject the view that Congress created a federal filing system and left priorities to federal common law. One major reason for creating a single filing system was to foster certainty in aircraft financing transactions. It hardly seems likely that Congress would have sought certainty in recording but left priorities to the slow and uncertain process of judicial development.

court that an examination of the entire opinion of the bankruptcy court shows that it did not misapply the burden of proof.[11] General Dynamics's contention to the contrary relies exclusively on one sentence in the opinion of the bankruptcy court: "The preponderance of the evidence simply does not establish or show that Stewart had any knowledge of any default by Ayer on his obligation to General Dynamics at the time he purchased these airplanes." Taken out of context, the sentence could be read as an allocation of the burden of proof, and such an allocation would be improper. But the sentence can just as easily be read as a description of the evidence.[12] The sentence is at most ambiguous, and there is no other indication anywhere in the opinion that the bankruptcy judge misapplied the burden of proof. Consequently, we conclude that the bankruptcy judge placed the burden where it belonged — on Gary.

Second, General Dynamics contends that, even if the bankruptcy judge acted properly in his assignment of the burden of proof, the holding must be reversed because the bankruptcy court considered Stewart's knowledge on December 22, 1971 and January 4, 1972, the dates of purchase, rather than on August 3, 1972, the date of recordation. The district court found some merit in General Dynamics's argument that

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[11] Even if the bankruptcy court had misapplied the burden of proof, that fact alone would not necessarily compel reversal. This court has held in a recent bankruptcy case that the allocation of the burden of proof is of concern primarily in a trial before a jury. *Katz v. Weil (In re Garfinkle),* 5 Cir. 1978, 577 F.2d 906, 910 (alternative holding).

[12] *See Katz v. Weil (In re Garfinkle),* 5 Cir. 1978, 577 F.2d 906. There, this court considered the following sentence from a bankruptcy judge's opinion: "The Court concludes that Curtis Katz has failed to prove by a preponderance of the evidence that he was vested with a valid beneficial ownership interest in the Eden Roc Hotel" In the context of the sentence immediately following — "On the contrary, the Court concludes that the preponderance of the evidence establishes that Curtis Katz. . . failed to take . . . action to cut off the redemptive rights of Barbara Garfinkle to protect her ownership interest in the Eden Roc Hotel." — the court viewed the first sentence as a description of the evidence rather than as an allocation of the burden of proof.

Stewart's knowledge was to be evaluated as of August 3 but declined to choose between the dates of purchase and the date of recordation, holding that use of the date of purchase would be harmless error because Stewart did not know of the default by Ayer even on August 3. General Dynamics argues to us that the district court's disposition of this issue was improper because August 3 was the relevant time, but the bankruptcy court had made no finding on the state of Stewart's knowledge in August. We disagree with General Dynamics on both grounds.

We conclude that the dates of purchase were the relevant dates. The rule of § 9.307(a) is designed to protect the innocent buyer against prior security interests in retail goods because he cannot be expected to discover those interests, while the secured party may generally be assumed to have authorized the sale of inventory by a retailer. *See generally, e.g.,* J. White & R. Summers, Uniform Commercial Code § 25-14 at 1070 (2d ed. 1980). But this "protection" leaves the buyer vulnerable if he cannot be certain of it until he records. Were that the rule, a buyer who discovered a violated security agreement after purchasing but before recording could have given consideration, in good faith and without knowledge, and taken possession of the goods but he would take a position subordinate to that of the secured lender. Measuring knowledge at the time of sale or earlier, however, prevents any gap in protection, for a potential buyer who discovers a violated security interest at the time of purchase can always decide not to buy.[13]

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[13] We find additional support for our conclusion that the dates of purchase are the relevant dates in the limited nature of the current controversy over when the protection of the buyer in the ordinary course attaches. Although there is some debate as to whether one who qualifies as a buyer in the ordinary course prevails over the secured lender if the lender attempts to foreclose before the buyer takes possession of the goods, no one seems to question that, from the time of delivery, the buyer prevails. *See* T. Quinn, UCC Commentary and Law Digest ¶ 3-307[A][8] (1978); Note, *When Does a Buyer Become a Buyer in Ordinary Course? UCC §§ 1-201(9), 9-307(1): A Test and a Proposal,* 60 Neb.L.Rev. 848, 875 (1981); *compare, e.g., Jones v. One Fifty Foot Gulfstar Motor Sailing Yacht,* 5 Cir. 1980, 625 F.2d 44, 47 n.4 (dictum) (the date of contract marks the beginning of protection, at least

In the alternative, we conclude that the bankruptcy judge did find that in August Stewart was without knowledge of any violation of the security agreement between Ayer and General Dynamics. His opinion stated that Stewart was unaware of the lien until after the time of purchase, "and *even then* the mortgage appeared to authorize Ayer to sell free of any lien. . . Stewart became *and remained* a buyer in ordinary course of business." Bankruptcy Court Op. at 6 (emphasis added).

Third, General Dynamics challenges the correctness of the holding that Stewart bought in good faith and without knowledge that the sale to him was in violation of the rights of General

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where the buyer has made partial payment) *with Martin Marietta Corp. v. New Jersey Nat'l Bank*, 3 Cir. 1979, 612 F.2d 745, 749 (assuming, without deciding, that the date of identification of the goods to the contract marks the beginning of protection) *and with Chrysler Corp. v. Adamatic, Inc.*, 1973, 59 Wis.2d 219, 208 N.W.2d 97, 106-07 (the passage of title marks the beginning of protection). Although one might argue that the buyer's qualification should be determined as of a date earlier than that on which the protection takes effect, surely the qualification should not be determined as of a *later* date.

General Dynamics cites no authority for its view that knowledge must be determined as of the date of recordation. It seems to rely entirely on 49 U.S.C. § 1403(c), which provides that no conveyance shall be valid as against third parties until recorded. Thus, according to General Dynamics, it could not lose its rights by operation of section 9.307(a) until Stewart recorded the conveyance, and Stewart would have to be without knowledge at the moment when General Dynamics would lose its rights if he is to take under section 9.307(a). To the extent that this argument reiterates the pre-emption argument, we have rejected it in Part II. The validity of General Dynamics's interest is governed by state law, which as our discussion in text shows, subordinates General Dynamics to a buyer in the ordinary course as of the date of purchase. Of course section 1403(c) does not affirmatively grant interests to third parties simply on the basis of the failure of the parties to the conveyance to record, and General Dynamics has no other claim arising after the failure to record; it did not in any way deal in reliance on recorded title. *See Peters v. Norris*, Tex. Civ.App. — Houston 1966, 402 S.W.2d 216, 219-20.

Dynamics.[14] Our holding above was based on alternative grounds — that the dates of purchase are the dates on which Stewart's knowledge is relevant and that the bankruptcy court found that Stewart acted in good faith and had no knowledge on the date of recordation. In keeping with that alternative holding, we will consider Stewart's knowledge and good faith on both dates, although General Dynamics's argument deals mainly with the date of recordation.

The holding that Stewart had no knowledge that the sale violated the security agreement between Ayer and General Dynamics is not clearly erroneous. There is nothing in the record to show any knowledge on the dates of purchase, for the results of the title search did not arrive until January 5, 1972, the day after the second purchase. Once those results arrived, there is nothing to indicate that Stewart saw the security agreement before August 3, 1972, and, even if he did, that agreement appeared to authorize the sale. The record supports the conclusion that Stewart first learned of the default by Ayer from General Dynamics's letter of May 28, 1976. We cannot re-evaluate Stewart's credibility in denying knowledge; that was a question for the trial judge.[15]

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[14] In its brief, General Dynamics urged that we hold these conclusions "clearly erroneous". At oral argument, though, it changed its position, now contending that the determination of buyer in the ordinary course status is a mixed question of law and fact, which would give us greater freedom to substitute our judgment for that of the trial judge. In support of its new position, it cites *Associates Discount Corp. v. Rattan Chevrolet, Inc.*, Tex.1970, 462 S.W.2d 546. That case held that summary judgment was improper when supported only by conclusory assertions that the sale was in the ordinary course of business because whether a *sale* is in the ordinary course of business is a mixed question of law and fact. The case did not hold, and we likewise refuse to hold, that the question of the buyer's knowledge is a mixed question. Some aspects of buyer in the ordinary course status may be mixed questions, as is the case with the question of good faith, reviewed below. *See id.;* Skilton, *Buyer in the Ordinary Course of Business under Article 9 of the Uniform Commercial Code,* 1974 Wis.L. Rev. 1, 31.

[15] General Dynamics has referred us to a number of facts that it argues establish that Stewart did not act in good faith and without knowledge. Most of the facts relate to the question of good faith and will be discussed below.

General Dynamics also contends that Stewart did not act in good faith, suggesting that he knowingly bought the planes for less than their value and that, though he was experienced in the sale of aircraft, did not undertake a title search before purchasing.[16] To show that Stewart purchased below market value, General Dynamics relies on the gain on the later sale of one of the planes and on the use of a higher value in the 1975 mortgage agreement between Gary and its bank. Stewart apparently made

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See note 17. None of them tend to establish that Stewart had knowledge on the dates of purchase or on the date of recordation. Only one of the facts requires any discussion at this point. General Dynamics asserts that "shortly after receiving notice of the liens in January 1972" Stewart learned of a lawsuit between Ayer and General Dynamics. The record is unclear as to how soon after January Stewart learned of the lawsuit. Even if it was before August 3, knowledge of the lawsuit still does not tend to show that Stewart knew that the sale to him violated the security agreement. The remaining facts relied upon by General Dynamics are simply irrelevant to Stewart's knowledge.

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[16] General Dynamics also notes a number of other facts that it views as evidence of Stewart's bad faith: (1) Stewart purchased the planes in his individual capacity, (2) he waited seven months to record his title, (3) he gave two planes to Gary and sold another one to Gary at a large gain, (4) in August 1976, Stewart and Gary obtained an indemnification agreement from Ayer, and (5) Gary's files contained a rough draft of a letter, never sent, that misrepresented the date on which Gary learned of the lien. The first three facts are obviously completely irrelevant to the question of Stewart's good faith. The indemnification agreement, obtained some four and a half years after the purchase, shows little about Stewart's good faith on that date or on the date of recordation; if anything, it tends to establish that he acted in good faith because he saw no need for such an agreement at those times. Finally, we are unmoved by General Dynamics's arguments that the rough draft of the letter establishes bad faith. First, the letter was clearly labeled a draft and was never sent, so, at most, it could establish that Stewart thought about acting in bad faith and decided not to do so. Second, the letter was drafted in 1976, long after Stewart's good or bad faith ceased to be relevant. Third, examination of the letter indicates that the author was uncertain of the date of the discovery of the liens, placed it shortly after Gary's sale of one of the planes and only later filled in that date, suggesting that there was no purposeful misrepresentation of the date of the discovery. Finally, the record does not establish that Stewart drafted the letter, and he denied having done so.

no profit on the sale of the group of planes, and, indeed, his profit on a sale four years down the line is but weak evidence that he originally paid less than fair value for the planes and even weaker evidence that he was aware that this was a bargain too good to be true. Similarly, the use of a higher value in a mortgage agreement consummated three years later is weak evidence of the 1972 market value.

Stewart's failure to undertake a title search presents a question only slightly more troublesome. The Texas courts have repeatedly stated that the test of good faith is not negligence or diligence and that it is immaterial that the buyer was aware of facts that would put a reasonably prudent person on inquiry. To lose his status as a buyer in the ordinary course, the buyer must have actual knowledge of facts or circumstances that amount to bad faith. *See, e.g., First State Bank & Trust Co. v. George,* Texas.Civ.App. — Corpus Christi 1974, 519 S.W.2d 198, *writ ref'd n. r. e.; Riley v. First State Bank,* Tex.Civ.App. — Amarillo 1971, 469 S.W.2d 812, 816; *Richardson Co. v. First National Bank,* Tex. Civ.App. — Tyler 1974, 504 S.W.2d 812, 816, *writ ref'd n. r. e.; cf. Citizens Bridge v. Guerra,* 1953, 152 Tex. 361, 258 S.W.2d 64, 69 (decided under predecessor statute). Thus, although a reasonably prudent person with Stewart's experience might have conducted a title search with the FAA before purchasing, Stewart's failure to do so does not, without more, establish that he acted in bad faith. *Accord, Northern Illinois Corp. v. Bishop Distributing Co.,* W.D.Mich.1968, 284 F.Supp. 121, 125 (no duty to search FAA records before purchasing aircraft from dealer); *Texas National Bank v. Aufderheide,* E.D.Ark.1964, 235 F.Supp. 599, 604 (same); *Cessna Finance Corp. v. Skyways Enterprises, Inc.,* Ky.1979, 580 S.W.2d 491, 494 n.7; *Suburban Trust & Savings Bank v. Campbell,* Ct. Common Pleas 1969, 19 Ohio Misc. 74, 48 Ohio Ops.2d 250, 250 N.E.2d 118, 121 (same). Nor did Stewart have actual knowledge of any circumstances that would put him in bad faith. We decline to overrule the holding that Stewart acted in good faith.[17]

[17] General Dynamics contends that the bankruptcy court and the district court failed to recognize the cases upon which it relies in its argument that Stewart

IV.

General Dynamics next argues that, even if Stewart qualifies as a buyer in the ordinary course of business, Gary cannot take good title for one of two reasons — first, the security interest was not created by Gary's seller and, second, Gary gave no consideration for the planes. Neither argument has merit.

The first argument is based on the limitation in section 9.307(a): a buyer in the ordinary course of business takes free of a security interest only if it was created by his seller. *See, e.g., National Shawmut Bank v. Jones,* 1967, 108 N.H. 386, 236 A.2d 484. General Dynamics, noting that the security interest it asserts was not created by Stewart (Gary's seller) but by Ayer, contends that Gary cannot be protected against that interest. This argument misses the mark, for Gary does not claim under section 9.307(a). On the contrary, its position is that Stewart took good title under section 9.307(a), and Gary, as Stewart's transferee, took whatever title Stewart had, under section 2.403(a), the "shelter" provision. It is therefore of no consequence that Gary's seller did not create the security interest. General Dynamics attempts to rebut this reasoning by relying on language in *National Shawmut Bank* stating that section 2-403

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acted in bad faith. We have considered those cases, and our conclusion is unchanged. The only Texas case cited, *International Harvester Co. v. Glendenning,* Tex.Civ.App. — Dallas 1974, 505 S.W.2d 320, is easily distinguishable. The buyer in that case acquiesced in the falsification of the sale documents to show that he had traded in used tractors in his purchase of a new one, when in fact he had not, and he repeated the misrepresentation to his seller's creditor. There was no such dishonesty here. The cases from other jurisdictions are similarly distinguishable. In *Taylor Motor Rental, Inc. v. Associates Discount Corp.,* 1961, 196 Pa.Super. 182, 173 A.2d 688, the party seeking to qualify as a buyer in the ordinary course was merely an alter-ego of the the seller, and the transaction had been undertaken in an attempt to avoid the creditor's security interest. The opinion in *Rex Financial Corp. v. Marshall,* N.D.Ark.1976, 406 F.Supp. 567, is not clear, but apparently the buyer was informed of the secured creditor's interest before the purchase, *id.* at 573, and the court held that Arkansas law, unlike Texas law, provided for constructive notice, *id.* at 577. Finally, in *Cosid, Inc. v. Bay Steel Products Co.,* Fla.App. 1971, 252 So.2d 274, the court merely overturned summary judgment for the buyer where he was aware of suspicious circumstances, remanding to allow the fact-finder to determine whether the buyer acted in good faith.

of the Uniform Commercial Code cannot provide an escape from the limitations of section 9-307. In *National Shawmut Bank* an individual sold a car, subject to a security interest, to a dealer, who then sold it to a buyer in the ordinary course of business. Since the security interest was not created by his seller, the last buyer in the chain could not take free and clear of the interest under section 9-307 of the UCC. Section 2.403(a) provides that a purchaser of goods acquires all title that his transferor had or had power to transfer, and that a seller with voidable title can transfer good title. If, under that provision, a retailer who bought subject to a security interest was one with voidable title and had the power to transfer good title, the "created by his seller" limitation of section 9.307(a) would be without any effect, so the *National Shawmut Bank* court held that section 2.403(a) does not provide an escape to section 9.307(a). That rule has been approved by the commentators, *see* J. White & R. Summers, Uniform Commercial Code § 25-15 (2d ed. 1980), and we do not question it. But the rule is that section 2.403(a) is not available to save one who buys when the seller's title is subject to a security interest but who does not qualify under section 9.307(a). It certainly does not mean that section 2.403(a) is not available to subsequent transferees from a successful section 9.307(a) buyer, as General Dynamics urges. *See* Skilton, *Buyer in the Ordinary Course of Business under Article 9 of the Uniform Commercial Code,* 1974 Wis.L. Rev. 1, 76 (viewing the point as "obvious"). If General Dynamics were correct, section 9.307(a) would be of scant benefit to the "protected" buyer in the ordinary course, for good title means little if one cannot transfer it. We hold that the lien of General Dynamics was extinguished upon the sale by Ayer to Stewart under section 9.307(a), and the subsequent sale to Gary could not resurrect it.

Finally, General Dynamics contends that Gary cannot take good title under section 2.403(a) because it furnished no consideration, receiving the aircraft as a gift.[18] We disagree. Section

[18] It is not clear how this argument would help General Dynamics if we accepted it. As we have already established, the sale to Stewart extinguished General Dynamics's lien. Even if Gary took less than good title from Stewart, we do not see how that would resurrect an extinguished lien; it would mean that *Stewart* retained some interest.

2.403(a) applies to a "purchaser" of goods, and section 1.201 defines a "purchaser" as one who takes by "sale, discount, negotiation, mortgage, pledge, lien, issue or reissue, *gift* or any other voluntary transaction". §§ 1.201(32), (33) (emphasis added).[19] The language could not be clearer. When the draftsmen of the Code wished to require consideration, they used the terms "buyer", "seller", and "sale", defined in sections 2.106(a) and 2.103(a)(1) to require consideration, instead of "purchaser", "transferor", and "purchase". *See, e.g.*, §§ 2.313, 2.314, 2.315. We cannot imagine applying any rule other than that a donee takes the title that his donor had.[20]

V.

We hold that the FAA does not preempt the provisions of the Texas Business and Commerce Code relating to the priority of interests in aircraft. Therefore, Stewart, as a buyer in the ordinary course of business, took the aircraft free and clear of the lien of General Dynamics. And Gary, as the transferee of Stewart, also took free and clear of the lien. Consequently, Gary is entitled to the possession of the remaining airplane and the proceeds of the airplane that was sold. The case is Affirmed.

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[19] Although chapter 2 is entitled "Sales", § 2.101, it expressly regulates purchasers in section 2.403, and adopts the general definition of "purchaser" from chapter 1, see § 2.103(d). Furthermore, under section 2.102, the scope of chapter 2 is defined as "transactions in goods", with no requirement of consideration. *See generally* J. White & R. Summers, Uniform Commercial Code § 1-1 at 22 (2d ed. 1980) (differentiating between "transactions in goods" and "sales"); T. Quinn, Uniform Commercial Code Commentary and Law Digest ¶ 2.102 [A] (1978).

[20] The cases cited by General Dynamics as requiring a "sale" to invoke the coverage of chapter 2 deal with the warranty provisions of the Code. *Allen v. Ortho Pharmaceutical Corp.*, S.D.Tex. 1974, 387 F.Supp. 364; *Harvey v. Sears, Roebuck and Co.*, Del.Super.1973, 315 A.2d 599. Since those provisions expressly require a sale, the cases are not instructive on the need for consideration under section 2.403, which does not require a sale.

APPENDIX B

IN THE

UNITED STATES DISTRICT COURT

FOR THE WESTERN DISTRICT OF TEXAS

SAN ANTONIO DIVISION

IN RE GARY AIRCRAFT CORPORATION,
Debtor,

GENERAL DYNAMICS CORPORATION,
Defendant/Appellant,
VS.

GARY AIRCRAFT CORPORATION,
Plaintiff/Appellee.

Cause No. SA-79-CA-505

Appeal from the United States Bankruptcy Court for the Western District of Texas, San Antonio Division.

Memorandum Opinion and Order

SESSIONS, District Judge:

Came on to be heard Defendant/Appellant's appeal from the Judgment of the United States Bankruptcy Court for the Western District of Texas, San Antonio Division in Cause No. SA-76-443-BK-T, per Honorable Bert W. Thompson, United States Bankruptcy Judge, dated October 4, 1979. The Court, having carefully considered the record, and the appellate briefs of the parties, enters the following Memorandum Opinion and Order:

This action concerns ownership of one airplane and the proceeds of the sale of another. On Feburary 20, 1969, Frederick B. Ayer & Associates ("Ayer"), a dealer and broker in airplanes, used airplanes and airplane parts, executed a mortgage in favor

of Defendant/Appellant General Dynamics Corporation ("General Dynamics") in two Douglas DC-6B Airplanes, FAA Registration Nos. N8221H and N8222H, including after-acquired property attached to or incorporated into the collateral. General Dynamics recorded its aircraft mortgage with the Federal Aviation Administration, as required by 49 U.S.C. Section 1403, on March 3, 1969. The mortgage provided that Ayer could not sell the collateral if in default under the mortgage. Arthur W. Stewart, founder and president of Plaintiff/Appellee Gary Aircraft Corporation ("Gary"), personally bought Airplanes N8221H and N8222H from Ayer on December 22, 1971 and January 4, 1972, respectively. William E. Crawford, vice-president and secretary-treasurer of Gary, requested a title search from the Aircraft Owners and Pilots Association ("AOPA") on the two airplanes on January 4, 1972. AOPA reported the next morning that General Dynamics claimed liens on both planes. Stewart recorded his bills of sale of Airplanes N8221H and N8222H on August 3, 1972. On November 7, 1975, Stewart transferred the two planes to Gary without consideration. G. V. Morton, associate counsel to General Dynamics, sent Crawford a letter dated May 28, 1976 advising him that General Dynamics still claimed liens against the aircraft and that Ayer's note was in default. Gary initiated Chapter XI bankruptcy proceedings on October 28, 1976. By consent of the parties, the Bankruptcy Court on May 9, 1978 allowed Gary to sell Airplane N8222H and deposit most of the proceeds in the registry of the Court. Gary had fitted the plane in 1976 with new engines and propellers and sold it for $250,000.00 on May 16, 1978. A creditor of Gary retained $18,750.00. The remaining $231,250.00 (plus accumulated interest) and the hull of Airplane N8221H (still in Gary's possession) were awarded to Gary by the Bankruptcy Court.

The Bankruptcy Court held that the registration provision of the Federal Aviation Act (49 U.S.C. 1401 et seq.) did not preempt state substantive law on lien priority, and that Stewart qualified as a buyer in the ordinary course of business under Ar-

ticle 9.307(1), Texas Business and Commerce Code, taking free of General Dynamics' liens. In support of the holding of buyer in the ordinary course status, the Bankruptcy Court held that Ayer was a dealer in goods of that kind and that Stewart had purchased the planes in good faith and without knowledge of the security interests or that the sale was in violation of General Dynamics' rights. The Bankruptcy Court further held that Gary acquired Stewart's clear title by means of the transfer. General Dynamics argues that the Bankruptcy Court erred in that:

> 1) The Federal Aviation Act, 49 U.S.C. 1401 et seq., does preempt state lien priority law;
> 2) The wrong time frame was employed in determining buyer in ordinary course status;
> 3) The wrong burden of proof was applied to the buyer in ordinary course issue;
> 4) The finding that Stewart acted in good faith is clearly erroneous;
> 5) The mortgage did not authorize sale of the airplanes; and
> 6) Gary could not have acquired Stewart's allegedly clear title by means of the 1975 transfer.

The Federal Aviation Act provides at 49 U.S.C Section 1403 for a comprehensive federal registration system for all instruments affecting the title to civil aircraft in this country. It further provides (in relevant part) that:

> (c) No conveyance or instrument the recording of which is provided for by subsection (a) of this section shall be valid in respect of such aircraft... against any person other than the person by whom the conveyance or other instrument is made or given, his heir or devisee, or any person having actual notice thereof, until such conveyance or other instrument is filed for recordation in the office of the Secretary of Transportation...

> (d) Each conveyance or other instrument recorded by means of or under the system provided for in subsection (a) or (b) of this section shall from the time of its filing for recordation be valid as to all persons without further or other recordation,...

However, Section 1406 provides (in relevant part) that:

> The validity of any instrument the recording of which is provided for by section 1403 of this title shall be governed by the laws of the State, District of Columbia, or territory or possession of the United States in which such instrument or the place of delivery of the property which is the subject of such instrument...

There is a split of authority as to whether Section 1403 preempts state buyer in ordinary course doctrines. Compare *Sanders* v. *M. D. Aircraft Sales, Inc.*, 575 F.2d 1086 (3rd Cir. 1978); *Haynes* v. *General Credit Corp.*, 432 F.Supp. 763 (W.D. Va. 1977); and *Bank of Hendersonville* v. *Red Baron Flying Club, Inc.*, 571 S.W.2d 152 (Tenn.Ct.App. 1977) (no preemption) with *Dowell* v. *Beech Acceptance Corp.*, 3 Cal.3d 544, 476 P.2d 401; cert. denied 404 U.S. 823 (1971); *O'Neill* v. *Barnett Bank of Jacksonville*, 360 So.2d 150 (Fla.Dist.Ct.App. 1978); and *In re Veterans' Air Express Co.*, 76 F.Supp. 684 (D.N.J. 1948) (preemption). This Court considers *Sanders*, the only federal appellate case directly on point, to be the most authoritative statement. Even were this a case of first impression, however, this Court would hold that the recordation system of the Federal Aviation Act does not preempt the Texas buyer in ordinary course doctrine. The Third Circuit noted in *Sanders* that the legislative history of Section 1406 (enacted in 1964) reflects that Congress assumed that state substantive law controlled the legal effect of instruments recorded under Section 1403 (enacted in 1958), and added Section 1406 only to resolve thorny conflict of law problems. The Fifth Circuit held in *Bank of Lexington* v. *Jack Adams Aircraft Sales, Inc.*, 570 F.2d 1220, 1225 (5th Cir. 1978), that the Federal Aviation Act

preempts state law only insofar as it conflicts with provisions of the Act. Since the Act did not address the question of viability of assignments of security interests, the Court ruled that state law controlled.

The absolute language of Section 1403(d) that any instrument recorded under the Act, "shall from the time of its filing for recordation be valid as to all persons...," cannot be given literal effect in light of Section 1406. Even without Section 1406, it is difficult to imagine that Congress intended for aircraft liens to be valid simply because they have been recorded. One could argue that the Federal Aviation Act contemplates that state law control only the original validity of an instrument recorded under it, and not the effect of future events such as sale in the ordinary course of business. The "valid as to all persons" language could be construed as negating a buyer in ordinary course doctrine. However, the Court feels that the more reasonable interpretation is that the Act establishes a unitary and final recording system which all persons must search who have a duty to search in the first place. Buyers in the ordinary course have no such duty. Even a sophisticated buyer such as Mr. Stewart would not expect to be bound by floor-plan financing arrangements entered into by a dealer in the type of goods he purchases. Moreover, this Court cannot find that Congress has preempted the venerable but still commercially important doctrine of buyer in ordinary course, now uniformly codified in forty-nine states by adoption of the Uniform Commercial Code, without a clearer indication than Section 1403 supplies.[1]

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[1] General Dynamics also argues that state law must be considered preempted because even Texas courts hold that the Federal Aviation Act preempts the field of conveyancing in aircraft, citing *Continental Radio Co., Inc.* v. *Continental Bank and Trust Co.*, 369 S.W.2d 359 (Tex.Civ.App.—Houston, 1963) writ ref'd. n.r.e. However, the "preempt the field" statement in that case is dictum. At issue was whether a Texas constitutional mechanic's lien, which is perfected without filing, was superior to a bank's lien subsequently perfected by filing under Section 1403. This relates to the fact of recordation, an area definitely preempted by Section 1403. Moreover, *Continental* predates the enactment of Section 1406.

General Dynamics' next three points, that the Bankruptcy Court applied the wrong time frame and wrong burden of proof and was clearly erroneous in determining that Stewart qualified as a buyer in the ordinary course, will be considered together. General Dynamics argues that Stewart's status as a buyer in the ordinary course must be determined not as of December 22, 1971 and January 4, 1972 (the dates of tender of consideration and delivery of the planes) but as of August 3, 1972, (the date Stewart recorded his bills of sale with the FAA). This position has merit in light of Section 1403(c)'s provision that no conveyance required to be recorded shall be valid against third parties without notice until recorded. However, the only knowledge acquired by Stewart in the period between January 4, 1972 and August 3, 1972 was that General Dynamics did claim a lien against Airplanes N8221H and N8222H. Article 9.307(a), Tex.Bus.&Comm.Code, provides that a buyer in ordinary course takes free of a security interest even though he knows of its existence. The good faith requirement is contained in the definition of "buyer in the ordinary course of business", Article 1.201(i): "a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind..." The security agreement in this case allowed sale of the collateral except when Ayer was in default. The Bankruptcy Court found that, even after learning of the existence of the liens, Stewart still had no reason to think the sale was unauthorized. Bankruptcy Court Opinion, p. 4. Therefore, unless this determination results from a misplacing of the burden of proof or is clearly erroneous, the time frame for determining buyer in ordinary course status is immaterial.

General Dynamics' burden of proof argument centers on one sentence in the Bankruptcy Court opinion:

> The preponderance of the evidence simply does not establish or show that Stewart had knowledge of any

> default by Ayer on his obligation to General Dynamics at the time he purchased these airplanes.

Bankruptcy Court Opinion, p.4. General Dynamics maintains that Texas law places the burden of proving buyer in ordinary course status on the party seeking its protections. It cites *Matter of Garfinkle,* 577 F.2d 906 (5th Cir. 1978), for the proposition that such a misplacement of the burden of proof by a Bankruptcy Court is reversible error where the evidence is not so overwhelming that the other party would have surpassed the correct burden of proof. However, one-sidedness of the evidence was only one basis for the holding in *Garfinkle*. The Fifth Circuit noted that allocation of the burden of proof is primarily a matter of concern in a jury trial. *Id.* at 910. As in *Garfinkle*, the contention here of error in allocation of burden of proof is based on an isolated sentence. Taken as a whole, the Bankruptcy Court opinion does not formally place the burden of proof on General Dynamics on this issue. Therefore, it is unnecessary to determine whether in fact Texas law places the burden of proof on one seeking buyer in ordinary course status.

In support of its claim of error in the Bankruptcy Court's determination that Stewart acted in good faith and without knowledge that the sale to him was in violation of the rights of a third party, General Dynamics asserts, inter alia, that:

> 1) Stewart was a sophisticated aircraft buyer and a founding member of AOPA, yet failed to make a title check.
>
> 2) Stewart knew of a lawsuit and "a battle" between General Dynamics and Ayer shortly after learning of the existence of the liens in January, 1972.
>
> 3) Stewart paid $5,000 each for the aircraft when their approximate market value was $25,000 each.
>
> 4) Gary's files contained a rough draft letter in response to the May 28, 1976 letter from General Dynamics which misrepresented the time Gary learned

of the existence of the liens. (The letter was apparently never sent.)[2]

Point 2 is simply not supported by the record. The portion of the transcript quoted by General Dynamics in its brief to show Stewart's knowledge is at worst ambiguous as to his knowledge:

Q: Well, what did they say in conversation with you when you or Mr. Crawford spoke to them, what did they say about the General Dynamics lien? What was their explanation?

A: Well, I think Mr. Crawford told me that there was some lawsuit, and it was all settled, and not to worry about it. If we sold an airplane, they would clear it, which is what happened the first and second times.

Q: Now, when he said there was some lawsuit, what lawsuit?

A: I don't know. This could have been that year, the next year, or three years. It is very difficult for me to separate these things, but basically I think at one time or another the air company told me they were having a battle with General Dynamics. Now whether—

Q: Who is "They were having a battle"? Who do you mean by "they"?

A: Frederick B. Ayer Company, somebody there told Mr. Crawford that they were having a battle with General Dynamics.

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[2] The Court is unable to perceive any merit in General Dynamics other points, concerning the fact that Stewart purchased the airplanes in his own name instead of his company's, the time between Stewart's purchase and his filing of his bills of sale, the fact that Stewart sold another airplane (not involved in this action) to Gary at a profit, the fact that there had been no consideration for the transfer of Airplanes N8221H and N8222H from Stewart to Gary, the fact that Stewart never contacted General Dynamics about the lien problems, and the fact that Stewart and Gary obtained an indemnity agreement from Ayer after learning of the title problems.

Transcript, 92-93; Defendant/Appellant's Brief, 26. From this and the fact that the liens had not been cleared within a reasonable period, General Dynamics concludes that Stewart "knew or reasonably should have known" that the sale to him had been in violation of its rights. However, Article 1.201(25) provides that a person "knows" or has "knowledge" of a fact when he has *actual* knowledge of it.

The Court does not agree with Gary that the alleged misrepresentation in the rough draft letter composed some four years after the purchases and never sent could not possibly be probative of Stewart's state of mind at the time of the purchases. If Stewart had bought the airplanes in bad faith, it would be in his interest to continue, four years later, to misrepresent his state of mind. Likewise, the allegations that Stewart was a sophisticated buyer, knew of the AOPA title search service but did not use it, and bought the planes for less than market value, if true, would permit an inference of bad faith. However, to label the Bankruptcy Court's finding "clearly erroneous" on the basis of these inferences would be unwarranted. The Bankruptcy Judge heard all the evidence, including Stewart's repeated protestations that he did not know that the sale was in violation of General Dynamics' rights until he saw the May 28, 1976 letter. Deposition testimony of Frederick B. Ayer, read into the record, tends to confirm Stewart's lack of knowledge. The Bankruptcy Judge observed and evaluated the witnesses' demeanor. This Court will not overturn his determination on the basis of permissible, but not compelling, inferences.

General Dynamics relies on a stipulation that it never "consented" to the transfer of the planes to Stewart and a judgment of an Arizona state court that Ayer was in default on its obligation to General Dynamics beginning on December 31, 1970 in support of its claim that the sale was not authorized. However, since Stewart did not know that Ayer was in default, he qualifies as a buyer in ordinary course. It is therefore not necessary to decide whether General Dynamics consented to the sale of this particular collateral.

Finally, General Dynamics argues that Gary cannot claim Stewart's buyer in ordinary course protection because the security interest at issue was not created by Gary's seller, citing *National Shawmut Bank of Boston* v. *Jones*, 236 A.2d 484 (N.H., 1967) and *United States* v. *Hext*, 444 F.2d 804 (5th Cir. 1971). However, both these cases involved buyers seeking buyer in ordinary course protection whose sellers themselves did not have buyer in ordinary course protection under UCC Article 9.307(1). Furthermore, Gary does not even claim buyer in ordinary course status[3]; rather, it contends that it succeeded to whatever title Stewart had by virtue of Article 2.403(a), which provides in relevant part:

> A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased.

General Dynamics' argument that Gary cannot come within Article 2.403(a) because the transfer was without consideration is without merit. Article 1.201(33) defines "purchaser" as one who takes by "purchase" and Article 1.201(33) includes taking by gift within its definition of "purchase". There is an understandable lack of case law for the proposition that one who takes from another who had clear title also generally has clear title. Article 2.403(a) is plain on its face, and it is impossible to defend any other rule either by formal logic or policy arguments. Therefore,

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[3] The fact that the lien had not been created by Stewart would not prevent Gary from being a buyer in the ordinary course, anyway. It would merely deny Gary the protection of Article 9.307(1). The reason Gary cannot be a buyer in the ordinary course is that its seller, Stewart, was not personally in the business of selling airplanes, and because of the lack of consideration. See Art. 1.201(9).

It is hereby ordered that the Judgment of the United States Bankruptcy Court for the Western District of Texas, San Antonio Division, in Cause No. SA-76-443-BK-T is in all things Affirmed;

It is further ordered that Defendant/Appellant reimburse Plaintiff/Appellee for costs of appeal, as provided in Rule 811 of the Rules of Bankruptcy Procedure.

APPENDIX C

In The
United States District Court
For The Western District of Texas
San Antonio, Division

In Re
Gary Aircraft Corporation
Debtor

Gary Aircraft Corporation
Plaintiff

vs.

General Dynamics Corporation,
Defendant

In Bankruptcy

No. SA-76-443-BK-T

Chapter XI

(Adversary "A")

Memorandum Order and Opinion

THOMPSON, Bankruptcy Judge:

At San Antonio, in said District, on the 1st day of May, 1979, came on for hearing and consideration the Debtor, Gary Aircraft Corporation's (Gary Aircraft) Complaint to Determine the Validity and Extent of Lien of General Dynamics Corporation in the above styled adversary proceeding. In Counts One and Two of its Complaint, Gary Aircraft requested the Court's con-

sideration and determination of the existence and extent of a lien asserted by Defendant, General Dynamics Corporation (General Dynamics) against two DC-6B airplanes purchased by Gary Aircraft. Only these two counts are considered herein as Counts Three and Four were heretofore severed for separate trial as to those issues by previous Order of the Court.

The Court having heard and considered the evidence presented in open Court; the testimony of the witnesses; the arguments of counsel and the legal authorities cited by the respective parties, hereby renders the following Memorandum Opinion and Order which shall constitute the Court's Findings of Fact, Conclusions of Law and Order. In this connection, all Findings of Fact may be considered Conclusions of Law, if appropriate. All Conclusions of Law may be considered as Findings of Fact, if appropriate. All Findings of Fact and Conclusions of Law not specifically made herein are deemed made in support of this Memorandum Opinion and Order.

This Controversy arises from the acquisition of two Douglas DC-6B airplanes, FAA registry numbers N8221H and N8222H, by Gary Aircraft. These two planes were purchased by Mr. Arthur W. Stewart (Stewart), President of Gary Aircraft in December, 1971 and January, 1972 respectively. Stewart purchased these two airplanes for a price of Five Thousand Dollars ($5,000.00) each from Frederick B. Ayer & Associates (Ayer), whose line of business included selling used airplanes, engines and parts. Prior to said aircraft sales, Ayer had granted to General Dynamics a security interest (Mortgage) in the two airplanes. This security interest had been filed with the Recordation Office of the Federal Aviation Administration (FAA) in Oklahoma City, Oklahoma pursuant to 49 U.S.C. 1403 (1958) in March, 1969. The mortgage included an after-acquired property clause relating to all property subsequently attached to or incorporated in the original collateral. Such mortgage further contained and recited the mortgagee's, General Dynamics, consent to any sale made by Ayer except only when Ayer was in default of his obligation to General Dynamics.

After Stewart purchased the aircraft from Ayer, he and Gary Aircraft jointly requested and received a "Report of Title Search" disclosing for the first time to Stewart and Gary Aircraft, the aforementioned mortgage filed by General Dynamics which encumbered airplanes N8221H and N8222H, as well as other inventory held and owned by Ayer that was daily offered for sale to the public. Stewart thereafter filed the bills of sale to these two airplanes with the FAA on July 20, 1972, with knowledge of the existence of said encumbrance. Thereafter, on November 7, 1979, Stewart executed a bill of sale transferring title to airplanes N8221H and N8222H to Gary Aircraft whereby Gary Aircraft acquired all interests previously held and owned by Stewart in and to such aircrafts. In late 1976, Gary Aircraft overhauled airplane N8222H by installing four Pratt & Whitney R2800 engines with quick engine change kits and four Hamilton Standard Model 43E60 propellers. The airplane was then sold for Two Hundred Fifty Thousand Dollars ($250,000.00) pursuant to an Order of this Court, and the proceeds of sale were thereafter impounded pending a determination of proper disposition by this Court.

Defendant, General Dynamics, claimed a lien on the hulls of both airplanes sold by Ayer in a writing to Gary Aircraft in May 1976. It also claimed an interest in four engines, the propellers and related equipment installed on airplane N8222H pursuant to the after-acquired property clause contained in its mortgage. In Order to resolve this claim, Plaintiff, Gary Aircraft filed the instant adversary proceeding under its authority as Debtor-In Possession within the Chapter XI Arrangement it instituted on October 28, 1976.

The threshold issue in the instant proceeding is whether Stewart took the two airplanes subject to the security interest held by the Defendant, General Dynamics. Stewart did not make a title search, of the FAA records prior to purchasing the aircraft from Ayer. Only after the sale was consummated and completed did he request the title search, which thereafter

reported the existence of the mortgage held by General Dynamics.

The Federal Aviation Act of 1958, 49 U.S.C. 1200 *et seq.*, preempts the state law concerning the registration and recording of title instruments in commercial aircraft. *Pacific Financial Corp. v. Central Bank & Trust Co.*, 296 F2d 68,71 (5th Cir. 1961). Section 503 of the Aviation Act, 49 U.S.C 1403, controls the recordation requirements of all security and title interest in the aircraft, aircraft engines, propellers and appliances. The Aviation Act *does not* address itself to the resolution of conflicting claims of priority however, and as a result, state substantive law is applied in and to such situations. *Sanders* v. *M.D. Aircraft, Inc.*, 575 F2d 1086 (3rd Cir. 1978). The Court of Appeals, 5th Circuit, has held that the Federal Aviation Act preempts state law insofar as the state law conflicts with the federal provisions. *Bank of Lexington* v. *Jack Adams Aircraft Sales, Inc.*, 570 F2d 1220, 1224 (5th Cir. 1978).

Under the facts in the case at bar, the priority of claims conflict is controlled by the Texas Business and Commerce Code (T.B.C.C.), V.A.T.S., (1967). Section 9.307 of the Code provides that usually a buyer in the ordinary course of business takes free and clear of a security interest created by his seller even though the security interest is *perfected* and even though the buyer *knows* of the *existence* of the perfected security interest. This general rule obtains under the facts now before the Court. The buyer in ordinary course is defined as one who buys "in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods, and who buys in the ordinary course of business from a person in the business of selling goods of that kind..." T.B.C.C. 1.201(9).

The resulting doctrine provides that one who buys from a merchant dealing in goods of the kind takes free of any perfected security interest in those *unless he knows* the transaction is in violation of some term in the security agreement.

T.B.C.C. 9.307, Comment 2. It is only reasonable that a purchaser expects his seller's floorplanner to encourage the turnover of inventory, allowing the merchant the right to sell the particular commodity without requiring the purchaser to research the terms of any security agreement. *Texas National Bank* v. *Aufderheide,* 235 F. Supp. 599 (E.D. Ark. 1964).

"The buyer in ordinary course doctrine" has been applied to the sales of aircraft by dealers of same acting in the ordinary course of business. *Aufderheide,* id. "The buyer in ordinary course doctrine" *is only necessary* where the security agreement *forbids* the merchant to sell his inventory. For example, the Aufderheide security agreement *did not authorize* the aircraft dealer to sell his inventory without the consent of the secured party. Nevertheless, the purchaser from the merchant took free of the lien because he was a buyer *in ordinary course of business.*

If the sale of the mortgaged inventory is authorized either by the security agreement or conduct, § 9.306 of the Business and Commerce Code controls. Where the sale is authorized, the transferee takes free of the lien and the secured party's only right will be to the proceeds of the sale in the hands of his debtor, the selling merchant. *T.B.C.C. 9.306, Comment 3.*

In applying these principles to the fact in the case at bar, the Court finds that Ayer was a recognized dealer in aircraft and in the sale of aircraft and was acting in the ordinary course of business during the sale of said two used aircraft to Stewart. The Court further finds that Stewart qualified for the classification of a buyer in ordinary course by his good faith purchase of the two airplanes. He had no knowledge at the time of purchase of any security interest held by General Dynamics. Even after he received knowledge of the existence of this security interest, he still had no reason to think the sale was unauthorized. The security agreement filed by General Dynamics with the FAA expressly allowed sales of the collateral, except only when Ayer was in default on his obligations to General Dynamics.

The preponderance of the evidence simply does not establish or show that Stewart had knowledge of any default by Ayer on his obligation to General Dynamics at the time he purchased these airplanes. Therefore, he knew of no violation of the security agreement between Ayer and General Dynamics and was without knowledge with respect to same. Under the clear mandate of § 9.307, Stewart took ownership and title to airplanes N8221H and N8222H free and clear of any security interest or lien or claim of General Dynamics in and to said aircraft.

When Stewart transferred all of his interest by his sale to Gary Aircraft, there was and could be no possible revival of the lien held or claimed by General Dynamics. The policy of the Texas Business and Commerce Code in allowing transfers of full title to a buyer in the ordinary course of business is to prevent confusion or injustice within commerce. *T.B.C.C. 2.403, Comment 3.* Gary Aircraft assumed and succeeded to the title and status held and owned by Stewart upon its purchase of the two airplanes. Therefore, General Dynamics has no claim against the vendee of a buyer in ordinary course who himself took free of its lien. The effect of a contrary rule would create havoc in the marketplace.

The Court therefore concludes that both Stewart and Gary Aircraft took free and clear of General Dynamics' security interest in the two specified DC-6B aircraft. The totality of the evidence established that Stewart obtained knowledge of the existence of such lien only after he purchased the airplanes, and even then the mortgage appeared to authorize Ayer to sell free of any lien. By not knowing of any violation of the security agreement, Stewart became and remained a buyer in ordinary course of business and the airplanes were relieved and discharged from any encumbrance previously held by General Dynamics. When Gary Aircraft purchased Stewart's interest in the airplanes, it received his full title unencumbered by any claim or lien of General Dynamics.

It is stipulated that General Dynamics' claim to a security interest in the propellers, engines, equipment and other accessories which Gary Aircraft attached to the improved airplane depended entirely upon the terms and provisions of its FAA mortgage against the hull of airplane N8222H. General Dynamics did not attempt to file any separate security interest in the engines and propellers which Gary Aircraft added to this aircraft after becoming the owner of same. It is the conclusion and opinion of the Court that since General Dynamics had no security interest against the hull of the aircraft in the hands of Gary Aircraft, it has no security interest in the afterattached equipment.

In view of the foregoing it is the Order and Judgment of the Court that the Debtor, Gary Aircraft Corporation, holds and owns the hull of airplane N8221H free and clear of any security interest asserted and claimed by General Dynamics. It is the further Order and Judgment of the Court that Gary Aircraft Corporation is entitled to the entire Two Hundred Fifty Thousand Dollars ($250,000.00) proceeds of sale of and from airplane N8222H, plus all accrued interest thereon, and without any indebtedness to or claim of Defendant, General Dynamics in and to such proceeds of sale.

APPENDIX D

THE FEDERAL AVIATION ACT

§ 1302. Consideration of matters in public interest by Board

Factors for interstate, overseas, and foreign air transportation

(a) In the exercise and performance of its powers and duties under this chapter, the Board shall consider the following, among other things, as being in the public interest, and in accordance with the public convenience and necessity:

(1) The assignment and maintenance of safety as the highest priority in air commerce, and prior to the authorization of new air transportation services, full evaluation of the recommendations of the Secretary of Transportation on the safety implications of such new services and full evaluation of any report or recommendation submitted under section 1307 of this title.

(2) The prevention of any deterioration in established safety procedures, recognizing the clear intent, encouragement, and dedication of the Congress to the furtherance of the highest degree of safety in air transportation and air commerce, and the maintenance of the safety vigilance that has evolved within air transportation and air commerce and has come to be expected by the traveling and shipping public.

(3) The availability of a variety of adequate, economic, efficient, and low-price services by air carriers and foreign air carriers without unjust discriminations, undue preferences or advantages, or unfair or deceptive practices, the need to improve relations among, and coordinate transportation by, air carriers, and the need to encourage fair wages and equitable working conditions for air carriers.

(4) The placement of maximum reliance on competitive market forces and on actual and potential competition (A) to provide the needed air transportation

system, and (B) to encourage efficient and well-managed carriers to earn adequate profits and to attract capital, taking account, nevertheless, of material differences, if any, which may exist between interstate and overseas air transportation, on the one hand, and foreign air transportation, on the other.

(5) The development and maintenance of a sound regulatory environment which is responsive to the needs of the public and in which decisions are reached promptly in order to facilitate adaption of the air transportation system to the present and future needs of the domestic and foreign commerce of the United States, the Postal Service, and the national defense.

(6) The encouragement of air service at major urban areas in the United States through secondary or satellite airports, where consistent with regional airport plans of regional and local authorities, and when such encouragement is endorsed by appropriate State entities encouraging such service by air carriers whose sole responsibility in any specific market is to provide service exclusively at the secondary or satellite airport, and fostering an environment which reasonably enables such carriers to establish themselves and to develop their secondary or satellite airport services.

(7) The prevention of unfair, deceptive, predatory, or anticompetitive practices in air transportation, and the avoidance of—

(A) unreasonable industry concentration, excessive market domination, and monopoly power; and

(B) other conditions;

that would tend to allow one or more air carriers or foreign air carriers unreasonably to increase prices, reduce services, or exclude competition in air transportation.

(8) The maintenance of a comprehensive and convenient system of continuous scheduled interstate and overseas airline service for small communities and for isolated areas in the United States, with direct Federal assistance where appropriate.

(9) The encouragement, development, and maintenance of an air transportation system relying on actual and potential competition to provide efficiency, innovation, and low prices, and to determine the variety, quality, and price of air transportation services.

(10) The encouragement of entry into air transportation markets by new air carriers, the encouragement of entry into additional air transportation markets by existing air carriers, and the continued strengthening of small air carriers so as to assure a more effective competitive airline industry.

(11) The promotion, encouragement, and development of civil aeronautics and a viable, privately owned United States air transport industry.

(12) The strengthening of the competitive position of United States air carriers to at least assure equality with foreign air carriers, including the attainment of opportunities for United States air carriers to maintain and increase their profitability, in foreign air transportation.

Factors for all-cargo air service

(b) In addition to the declaration of policy set forth in subsection (a) of this section, the Board, in the exercise and performance of its powers and duties under this chapter with respect to all-cargo air service shall consider the following, among other things, as being in the public interest:

(1) The encouragement and development of an expedited all-cargo air service system, provided by private enterprise, responsive to (A) the present and future needs of shippers, (B) the commerce of the United States, and (C) the national defense.

(2) The encouragement and development of an integrated transportation system relying upon competitive market forces to determine the extent, variety, quality, and price of such services.

(3) The provision of services without unjust discriminations, undue preferences or advantages, unfair or deceptive practices, or predatory pricing.

§ 1403. Recordation of aircraft ownership

Establishment of recording system

(a) The Secretary of Transportation shall establish and maintain a system for the recording of each and all of the following:

(1) Any conveyance which affects the title to, or any interest in, any civil aircraft of the United States;

(2) Any lease, and any mortgage, equipment trust, contract of conditional sale, or other instrument executed for security purposes, which lease or other instrument affects the title to, or any interest in, any specifically identified aircraft engine or engines of seven hundred and fifty or more rated takeoff horsepower for each such engine or the equivalent of such horsepower, or any specifically identified aircraft propeller capable of absorbing seven hundred and fifty or more rated takeoff shaft horsepower, and also any assignment or amendment thereof or supplement thereto;

(3) Any lease, and any mortgage, equipment trust, contract of conditional sale, or other instrument executed for security purposes, which lease or other instrument affects the title to, or any interest in, any aircraft engines, propellers, or appliances maintained by or on behalf of an air carrier certificated under section 1424(b) of this title for installation or use in aircraft, aircraft engines, or propellers, or any spare parts maintained by or on behalf of such air carrier, which instrument need only describe generally by types the engines, propellers, appliances, and spare parts covered thereby and designate the location or locations thereof; and also any assignment or amendment thereof or supplement thereto.

Recording of releases, cancellations, discharges, or satisfactions

(b) The Secretary of Transportation shall also record under the system provided for in subsection (a) of this section any release, cancellation, discharge, or satisfaction relating to any conveyance or other instrument recorded under said system.

Validity of conveyances or other instruments; filing

(c) No conveyance or instrument the recording of which is provided for by subsection (a) of this section shall be valid in respect of such aircraft, aircraft engine or engines, propellers, appliances, or spare parts against any person other than the person by whom the conveyance or other instrument is made or given, his heir or devisee, or any person having actual notice thereof, until such conveyance or other instrument is filed for recordation in the office of the Secretary of Transportation: *Provided,* That previous recording of any conveyance or instrument with the Administrator of the Civil Aeronautics Administration under the provisions of the Civil Aeronautics Act of 1938 shall have the same force and effect as though recorded as provided herein; and conveyances, the recording of which is provided for by subsection (a) (1) of this section made on or before August 21, 1938, and instruments, the recording of which is provided for by subsections (a) (2) and (a) (3) of this section made on or before June 19, 1948, shall not be subject to the provisions of this subsection.

Effect of recording

(d) Each conveyance or other instrument recorded by means of or under the system provided for in subsection (a) or (b) of this section shall from the time of its filing for recordation be valid as to all persons without further or other recordation, except that an instrument recorded pursuant to subsection (a) (3) of this section shall be effectively only with respect to those of such items which may from time to time be situated at the designated location or locations and only while so situated: *Provided,* That an instrument recorded under subsection (a) (2) of this section shall not be affected as to the engine or engines, or propeller or propellers, specifically identified therein, by any instrument theretofore or thereafter recorded pursuant to subsection (a) (3) of this section.

Form of conveyances or other instruments

(e) Except as the Secretary of Transportation may by regulation prescribe, no conveyance or other instrument shall be recorded unless it shall have been acknowledged before a

notary public or other officer authorized by the law of the United States, or of a State, territory, possession thereof, or the District of Columbia, to take acknowledgment of deeds.

Index of conveyances and other instruments

(f) The Secretary of Transportation shall keep a record of the time and date of the filing of conveyances and other instruments with him and of the time and date of recordation thereof. He shall record conveyances and other instruments filed with him in the order of their reception, in files to be kept for that purpose, and indexed according to—

(1) the identifying description of the aircraft, aircraft engine, or propeller, or in the case of an instrument referred to in subsection (a) (3) of this section, the location or locations specified therein, and

(2) the names of the parties to the conveyance or other instrument.

Regulations

(g) The Secretary of Transportation is authorized to provide by regulation for the endorsement upon certificates of registration, or aircraft certificates, of information with respect to the ownership of the aircraft for which each certificate is issued, the recording of discharges and satisfactions or recorded instruments, and other transactions affecting title to or interest in aircraft, aircraft engines, propellers, appliances, or parts, and for such other records, proceedings, and details as may be necessary to facilitate the determination of the rights of parties dealing with civil aircraft of the United States, aircraft engines, propellers, appliances, or parts.

Previously unrecorded ownership of aircraft

(h) The person applying for the issuance or renewal of an airworthiness certificate for an aircraft with respect to which there has been no recordation of ownership as provided in this section shall present with his application such information with respect to the ownership of the aircraft as the Secretary of Transportation shall deem necessary to show the

persons who are holders of property interests in such aircraft and the nature and extent of such interests.

§ 1406. Law governing validity of certain instruments

The validity of any instrument the recording of which is provided for by section 1403 of this title shall be governed by the laws of the State, District of Columbia, or territory or possession of the United States in which such instrument is delivered, irrespective of the location or the place of delivery of the property which is the subject of such instrument. Where the place of intended delivery of such instrument is specified therein, it shall constitute presumptive evidence that such instrument was delivered at the place so specified.

APPENDIX E

TEXAS BUSINESS AND COMMERCE CODE

§ 1.201 General Definitions

(9) "Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

§ 9.307 Protection of Buyers of Goods

(a) A buyer in ordinary course of business (Subdivision (9) of Section 1.201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

(b) In the case of consumer goods, a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family of household purposes unless prior to the purchase the secured party has filed a financing statement covering such goods.

(c) A buyer other than a buyer in ordinary course of business (Subsection (a) of this section) takes free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the purchase, or

more than 45 days after the purchase, whichever first occurs, unless made pursuant to a commitment entered into without knowledge of the purchase and before the expiration of the 45 day period.

Office-Supreme Court, U.S.
FILED
DEC 15 1982
ALEXANDER L. STEVAS,
CLERK

No. 82-777

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

IN THE MATTER OF
GARY AIRCRAFT CORPORATION,
Debtor

GENERAL DYNAMICS CORPORATION,
Petitioner

v.

GARY AIRCRAFT CORPORATION,
Respondent

On Writ Of Certiorari To The
United States Court Of Appeals
For The Fifth Circuit

BRIEF IN OPPOSITION

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No. 82-777

IN THE MATTER OF GARY AIRCRAFT CORPORATION,
Debtor

GENERAL DYNAMICS CORPORATION,
Petitioner

v.

GARY AIRCRAFT CORPORATION,
Respondent

LIST OF PARTIES

Pursuant to the Supreme Court Rule 28.1, Respondent lists the following parties, not named in the caption, which have an interest in the outcome of this case:

Victoria Bank and Trust Company
P.O. Box 1698
Victoria, Texas

Arthur W. Stewart
President, Gary Aircraft Corporation
Hondo Municipal Airport
Hondo, Texas

Frederick B. Ayer & Associates, Inc.
200 Park Avenue
New York, New York

Further, Respondent lists the following as its affiliates and subsidiaries (except wholly owned subsidiaries):

Madison Equipment Corporation
Hondo Municipal Airport
Hondo, Texas

Aircraft Machinery Corporation
Hondo Municipal Airport
Hondo, Texas

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No. 82-777

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On Writ Of Certiorari To The
United States Court Of Appeals
For The Fifth Circuit

BRIEF IN OPPOSITION

Respondent Gary Aircraft Corporation respectfully submits that a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in *Gary Aircraft Corporation v. General Dynamics Corporation* (No. 81-1378, *In the Matter of Gary Aircraft Corporation)* should not be granted.

OPINIONS BELOW

In addition to the opinions mentioned in the Petition for a Writ of Certiorari, the Bankruptcy Court entered an *Errata to Memorandum Order and Opinion Filed October 4, 1979* (App. A).

STATEMENT OF THE CASE

Petitioner General Dynamics Corporation incorrectly states that one of the two airplanes in question was transferred by Arthur W. Stewart to Respondent Gary Aircraft Corporation on March 12, 1982. As found by the Bankruptcy Court, both Airplanes N8221H and N8222H were transferred on November 7, 1982. Otherwise, Respondent accepts the Statement of the Case contained in the Petition for a Writ of Certiorari.

SUMMARY OF ARGUMENT

At issue is whether Section 503 of the Federal Aviation Act of 1958 (the "FAA"), 49 U.S.C. § 1403, was intended by Congress to establish substantive rules of lien priority, or whether it was intended simply to establish a central recording system for interests in aircraft. The opinion of the Fifth Circuit, based upon a thorough review of the legislative history, held that no substantive rules of lien priority were established by the FAA, and that such priorities were determined by state law.

Review by this Court is not justified by the conflict between the decision below and that of the California Supreme Court in *Dowell v. Beech Acceptance Corporation*, 13 Cal. 3d 544, 91 Cal. Rptr. 1, 476 P.2d 401 (Calif. 1970), *cert. denied*, 404 U.S. 823 (1971). The *Dowell* Court failed to analyze the legislative

history of the FAA. This fundamental flaw nullifies *Dowell's* precedential value and makes its conflict with the decision below insignificant.

The decision below does not conflict with the opinion of the Ninth Circuit in *Danning v. Pacific Propeller, Inc. (In re Holiday Airlines Corporation)*, 620 F.2d 731 (9th Cir.), *cert. denied*, 449 U.S. 900 (1980), as suggested by Petitioner. The *Pacific Propeller* court applied state law, in accord with the opinion below. Further, the Courts of Appeal for the Third,[1] Fourth,[2] Fifth,[3] Ninth,[4] and Tenth[5] Circuits have agreed that aircraft lien priorities are governed by state law, not by the FAA. Other federal and state court cases relied upon by Petitioner are not on point because they arose before the widespread adoption of the Uniform Commercial Code, dealt with other issues (predominantly possessory mechanics' liens), or reached aberrant results by failing to analyze the legislative history of the FAA.

In any event, it has now become so well established that the FAA does not govern priority of aircraft liens that no review by this Court is needed.

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[1] *Sanders v. M. D. Aircraft Sales, Inc.*, 575 F.2d 1086 (3rd Cir. 1978).

[2] *Haynes v. General Electric Credit Corp.*, 432 F. Supp 763 (W.D. Va. 1977), *aff'd per curiam*, 582 F.2d 869 (4th Cir. 1978).

[3] *Gary Aircraft Corporation v. General Dynamics Corporation (In re Gary Aircraft Corporation)*, 681 F.2d 365 (5th Cir. 1982); *Bank of Lexington v. Jack Adams Aircraft Sales, Inc.*, 570 F.2d 1220 (5th Cir. 1978).

[4] *CIM International v. United States*, 641 F.2d 671 (9th Cir. 1980).

[5] *State Securities Company v. Aviation Enterprises, Inc.*, 355 F.2d 225 (10th Cir. 1966).

ARGUMENT

I.
THE DECISIONAL CONFLICT BETWEEN THE SUPREME COURT OF CALIFORNIA AND THE FEDERAL COURTS OF APPEAL IS NOT OF SUFFICIENT IMPORTANCE TO MERIT REVIEW BY THIS COURT

This Court has indicated that a writ of certiorari will be granted only if special and important reasons exist therefor.[6] Petitioner correctly notes that a decisional conflict exists between the Supreme Court of California and several federal circuits as to whether FAA establishes rules of priority for aircraft liens. However, no special and important reasons exist for review by this Court. Because there is abundant judicial authority holding that state law governs aircraft lien priorities, little benefit would result from further review of the issue by this Court. Five federal courts of appeal[7] and two state courts of last resort[8] have taken the position that the FAA does not govern aircraft lien priorities. Several federal district courts and intermediate state courts are in accord.[9]

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[6] Rule 17.1, *Rules of the Supreme Court of the United States.*

[7] *See* notes 1-5, *supra.*

[8] *Bank of Hendersonville v. Red Baron Flying Club, Inc.*, 571 S.W.2d 152 (Ct. App. Tenn. 1977), *cert. denied*, 439 U.S. 1089; *Cessna Finance Corp. v. Skyways Enterprises, Inc.*, 23 UCC Rep. Serv. 1015 (Ky. Ct. App. 1978), *aff'd*, 580 S.W. 2d 491 (Ky. 1979).

[9] *Feldman v. Philadelphia National Bank*, 408 F. Supp. 24 (E.D. Pa. 1976); *Feldman v. First National City Bank*, 368 F. Supp. 1333 (S.D.N.Y. 1974); *United States Aviation Underwriters, Inc. v. WTAE Flying Club*, 300 F. Supp. 341 (W.D. Pa. 1969); *Northern Illinois Corporation v. Bishop Distributing Company*, 284 F. Supp. 121 (W.D. Mich. 1968); *Texas National Bank of Houston v. Aufderheide*, 235 F. Supp. 599 (E.D. Ark. 1964); *Bitzer-Croft Motors, Inc. v. Pioneer*

The primary authority for Petitioner's view of the FAA is *Dowell v. Beech Acceptance Corporation, supra.* In *Dowell* no effort was made to analyze the legislative history of the FAA. Had the *Dowell* Court reviewed this legislative history it might have discovered that the Senate, in debating the Civil Aeronautics Act (from which FAA was derived virtually *in haec verba*), deleted from Section 502 (now Section 503 of the FAA) a provision that would have afforded priority to recorded aircraft lien instruments.[10] Thus, Congress considered regulating the priority of recorded aircraft liens, but instead elected to leave this area to state law.

In 1964 the FAA was amended to delete from Section 503(c) (49.U.S.C. § 1403) the requirement that instruments presented for recording be acknowledged before a notary public, and to add Section 506 (49.U.S.C. § 1406), which provides that state law governs the validity of an instrument required to be recorded under the FAA. The legislative history of this amendment is set out in Appendix B hereto,[11] including a letter to the Honorable Warren G. Magnuson from N. E. Halaby, Administrator of the Federal Aviation Administration, in which it is stated (Appendix B, page B-8) (emphasis added):

> While recordation does afford notice to the world of the existence of an instrument affecting title, *it does not purport to establish the substantive validity of the instrument. As is the case with other recording systems, substantive validity of a recorded instrument remains a question of local law....*

Bank & Trust Company, 401 N.E.2d 1340 (App. Ct. Ill. 1980); *Southern Jersey Airways, Inc. v. National Bank of Secaucus*, 261 A.2d 399 (Superior Ct. N.J. 1970); *Suburban Trust & Savings Bank v. Campbell*, 250 N.E.2d 118 (Ct. Com. Pl. Ohio 1969); *Idabel National Bank v. Tucker*, 544 P.2d 1287 (Ct. App. Okla. 1975).

10 83 CONG. REC. 6757 (1938)

11 As taken from 1964 *U.S. Code Congressional and Administrative News*, Vol. 2, pp. 2322-2326.

The other cases favorable to Petitioner, *O'Neill v. Barnett Bank of Jacksonville,* 360 So. 2d 150 (Fla. Dist. Ct. App. 1978) and *Sun Bank v. Snell (In re Cone),* 11 B.R. 925 (M.D. Fla. 1981), similarly make no effort to review the legislative history of the FAA. Moreover, *O'Neill* is inconsistent with *Carolina Aircraft Corp. v. Commerce Trust Company,* 289 So. 2d 37 (Fla. Dist. Ct. App. 1974), and has been limited to its facts by *Michigan National Bank of Detroit v. Maierhoffer,* 382 So. 2d 318, 321 (Fla. Dist. Ct. App. 1978). And *Sun Bank* was wrongly decided. As explained by the Fifth Circuit's opinion below, *Sun Bank* misinterpreted *Pacific Propeller* by concluding the FAA preempts state aircraft lien priority law. 681 F.2d 370 n.5. *Pacific Propeller* suggests that *if* priority provisions were contained in the FAA, they would prevail over inconsistent state law. However, *Pacific Propeller* does not hold that the FAA actually contains such priority provisions, and *Pacific Propeller* applied state priority law.

Because *Dowell* failed to review and analyze the legislative history of the FAA it has been harshly criticized by courts and commentators alike.[12] Decisional conflicts between *Dowell* and subsequent cases are not new. Until *O'Neill, Dowell* had not been followed, while numerous federal and state courts ruled that state law determined aircraft lien priorities.[13] The *Dowell* decisional conflict has little troubled the courts facing the priority issue. Thus, there are no special or important reasons justifying review by this Court.

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[12] *See e.g., Gary Aircraft Corporation v. General Dynamics Corporation,* 681 F.2d at 370, n. 5; *Haynes v. General Electric Credit Corp.,* 432 F. Supp. at 768; *Taking the Lender for a Ride: Section 1403 of the Federal Aviation Act and the Buyer in the Ordinary Course of Business,* 36 WASH. & LEE. L. REV. 205, 221-222 (1979); Gantz, *Code-Secured Transactions and the Federal Aviation Act - A Limited Preemption,* 14 UCC L.J. 3, at 13-17 and 22.

[13] *See* notes 1-5, 8, and 9, *supra.*

II.
THERE IS NO CONFLICT AMONG THE COURTS OF APPEAL

Petitioner's assertion that the Fifth Circuit's decision below conflicts with that of Ninth Circuit in *Danning v. Pacific Propeller, supra,* is incorrect for two reasons. First, *Pacific Propeller* actually applied state law to determine lien rights in an aircraft; the case does not hold that the FAA contains any priority provisions. Second, as admitted on page 6 of the Petition for a Writ of Certiorari, *Pacific Propeller* only deals with the *validity* of a claimed lien – not its *priority*. Therefore, any discussion of the FAA as it relates to lien priority is mere *dicta*, not a holding of the Ninth Circuit.

While *Pacific Propeller* is not crystal clear, the Ninth Circuit's position on aircraft lien priorities is. In two decisions handed down after *Pacific Propeller* the Ninth Circuit has held that the FAA does not establish priority rules for aircraft liens. In *CIM International v. United States,* 641 F.2d 671, 675 n.6 (9th Cir. 1980), the Ninth Circuit relied upon *Pacific Propeller* for the proposition that the FAA does not preempt state priority laws, and in *Danning v. World Airways, Inc. (In re Holiday Airlines Corporation),* 647 F.2d 977, (9th. Cir 1981), the Ninth Circuit rejected the result in *Dowell* (647 F.2d at 980):

> . . .Several decisions upholding the rights of a purchaser in the ordinary course of business under state law as against holders of floor plan financing liens recorded under federal law employ the same approach. *See Sanders v. Aircraft Sales Inc.,* 575 F.2d 1086 (3d Cir. 1978); *Haynes v. General Electric Credit Corporation,* 582 F.2d 869 (4th Cir. 1978). Both *Sanders* and *Haynes* declined to read section 1406 so as to preempt provisions of the relevant state's version of the Uniform Commercial Code which were designed to protect purchasers in the ordinary course of business. The Supreme Court of California has

> reached the opposite conclusion. *See Dowell v. Beech Acceptance Corp., Inc.*, 3 Cal. 3d 544, 91 Cal., Rptr. 1, 476 P.2d 401 (1970). The financing agency prevailed over the buyer in the ordinary course of business because of the preemptive effect accorded section 1406 by the California court.
>
> Despite the reference of 49 U.S.C. § 1406 to state law as determining the validity of liens recorded under section 1403, we are not bound by state court decisions on the preemptive effect of federal law....

CIM and *World Airways*, do not conflict with the Fifth Circuit's decision below. These cases, as well as *Pacific Propeller*, agree with those of the Third, Fourth, Fifth, and Tenth Circuits in holding that the FAA does not establish substantive rules of priority for aircraft liens.

III.
THE ALLEGED CONFLICTS IN OTHER HOLDINGS INVOLVE DIFFERENT ISSUES AND DO NOT MEET THE CRITERIA FOR THE GRANTING OF A WRIT OF CERTIORARI

Many of the cases cited by Petitioner in support of its argument on pages 7-10 of the Petition for a Writ of Certiorari involve issues unrelated to the question here presented. Also, many of these cases were decided prior to the widespread enactment of the Uniform Commercial Code, and others deal with the issued of the *validity* (rather than the *priority*) of unrecorded mechanics' and artisans' liens. As a result, the conflicts alleged by Petitioner either do not exist, or are of no real importance.

There are only two lines of cases involving the issue of preemption by the FAA of the Uniform Commercial Code's

"buyer in the ordinary course of business" doctrine; *Dowell v. Beech Acceptance Corporation* (and its progeny *O'Neill v. Barnett Bank* and *Sun Bank v. Snell*) on the one hand, and the decisions of five federal circuits, two state courts of last resort, five federal district courts, and four intermediate state courts on the other.[14] There is remarkable uniformity in the decisions of these latter courts in support of the decision below. Furthermore, the doctrine propounded in *Dowell* has been criticized and rejected by legal commentators.[15] It is questionable whether even the California courts would follow *Dowell* at this time.

Finally, a conflict between intermediate state and lower federal courts does not constitute grounds for the granting of a writ of certiorari.[16]

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[14] *See* notes 1-5, 8, and 9, *supra*.

[15] Gantz, *Code-Secured Transactions and the Federal Aviation Act - A Limited Preemption*, 14 UCC L.J. 3 (1981); Sigman, *The Wild Blue Yonder: Interests in Aircraft under our Federal System*, 46 S. CAL. L. REV. 316 (1973); *Taking the Lender for a Ride: Section 1403 of the Federal Aviation Act and the Buyer in the Ordinary Course of Business*, 36 WASH. & LEE L. REV. 205 (1979); 37 J. AIR LAW & COMMERCE 252 (1971).

[16] Rule 17.1, *Rules of the Supreme Court of the United States*.

CONCLUSION

There is no conflict among the federal circuits on the issue of aircraft lien priority. The conflict caused by *Dowell* is not of sufficient importance to justify review by this Court.

This case does not present any of the special and important reasons required for the granting of a writ of certiorari. Accordingly, this Court should deny the Petition for a Writ of Certiorari.

Respectfully submitted,

Cecil Jay Olmstead III
Counsel for Respondent,
Gary Aircraft Corporation

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CERTIFICATE OF SERVICE

The undersigned, being at all times hereinafter mentioned more than eighteen years of age, certifies that on the 14th day of December, 1982, true and correct copies of the foregoing Brief in Opposition were served upon the attorneys of record for General Dynamics Corporation and Victoria Bank & Trust Company by depositing the same in the United States Mail, first-class postage prepaid, certified, return receipt requested, address as follows:

Mr. Gilbert Lang Mathews
Lang, Cross, Ladon, Boldrick & Green, P.C.
1565 Frost Bank Tower
San Antonio, Texas 78205

Mr. Munson Smith
Anderson, Smith, Null, Stofer & Smith
314 Victoria Bank & Trust Company Building
Victoria, Texas 77901

Cecil J. Olmstead

Cecil Jay Olmstead III

APPENDIX A

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

IN RE

GARY AIRCRAFT CORPORATION,
Debtor

GARY AIRCRAFT CORPORATION,
Plaintiff

VS.

GENERAL DYNAMICS CORPORATION,
Defendant

IN PROCEEDINGS FOR
AN ARRANGEMENT NO. SA-76-BK-443-T

ADVERSARY PROCEEDING "A"

ERRATA TO MEMORANDUM ORDER AND OPINION FILED OCTOBER 4, 1979

It has come to the attention of this Court that the Memorandum Order and Opinion filed in the captioned cause on October 4, 1979 contains a typographical error with respect to the date on which Mr. Arthur W. Stewart executed a bill of sale transferring title to Airplanes N8221H and N8222H to Gary Aircraft Corporation.

On page 2 of the Memorandum Order and Opinion (third sentence of the first full paragraph) it is stated that (emphasis added):

> Thereafter, on November 7, 1979, Stewart executed a bill of sale transferring title to airplanes N8221H and N8222H to Gary Aircraft whereby Gary Aircraft acquired all interests previously held and owned by Stewart in and to such aircrafts.

It appears to the Court from the stipulations of the parties and the evidence introduced at trial that the correct date for the execution of the bills of sale in question was November 7, 1975.

It is, therefore, ORDERED that the third sentence of the second paragraph of the second page of the Memorandum Order and Opinion filed herein on October 4, 1979, be and it hereby is, corrected to read as follows, such change to be effective as of October 4, 1979:

> Thereafter, on November 7, 1975, Stewart executed a bill of sale transferring title to Airplanes N8221H and N8222H to Gary Aircraft whereby Gary Aircarft acquired all interests previously held and owned by Stewart in and to such aircrafts.

SIGNED and ENTERED this 4th day of November, 1979, at San Antonio, Texas.

/s/ BERT W. THOMPSON

HONORABLE BERT W. THOMPSON
United States Bankruptcy Judge

AGREED AND APPROVED:

/s/ JAY OLMSTEAD

Jay Olmstead

FULBRIGHT & JAWORSKI
800 Bank of the Southwest Building
Houston, Texas 77002
(713) 651-5151

ATTORNEY FOR PLAINTIFF,
GARY AIRCRAFT CORPORATION

/s/ GILBERT LANG MATHEWS
Gilbert Lang Mathews

LANG, CROSS, LADON, BOLDRICK & GREEN
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ATTORNEY FOR DEFENDANT,
GENERAL DYNAMICS CORPORATION

APPENDIX B

AVIATION - RECORDING OF INSTRUMENTS

For text of Act see p. 281

Senate Report (Commerce Committee) No. 1060, June 5, 1964 [to accompany H.R. 8673]

House Report (Interstate and Foreign Commerce Committee) No. 1033, Dec. 12, 1963 [To accompany H.R. 8673]

Cong. Record Vol. 109 (1963)

Cong. Record Vol. 110 (1964)

DATES OF CONSIDERATION AND PASSAGE

House Dec. 17, 1963

Senate June 19, 1964

The Senate Report is set out.

Senate Report No. 1060

The Committee on Commerce, to whom was referred the bill (H.R. 8673) to amend title V of the Federal Aviation Act of 1958 to provide that the validity of an instrument the recording of which is provided for by such act shall be governed by the laws of the place in which such instrument is delivered, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE OF THE BILL

The bill would create a uniform Federal rule which would provide that the validity of certain instruments affecting title to or interest in aircraft shall be governed by the laws of the State, District of Columbia, territory, or possession in which they are delivered. Designation of the place of delivery in the instrument would constitute presumptive evidence that the instrument was delivered at the place so specified. The bill makes clear that this legislation in no way affects the Convention on the International Recognition of Rights in Aircraft. In addition, the Administrator of the Federal Aviation Agency would be authorized to except certain instruments from the present statutory requirement that they must be notarized before recordation.

ANALYSIS AND NEED FOR LEGISLATION

The bill is similar in purpose to S. 2773, 87th Congress, which was reported favorably by this committee September 4, 1962, and which passed the Senate September 7, 1962. This legislation incorporates recommendations originally proposed by the Bar Assocation of the City of New York and is designed to facilitate identification of local laws governing the validity of aircraft instruments. It establishes a uniform Federal rule governing the validity of instruments affecting title to or interests in aircraft and related equipment. The rule would apply to all instruments subject to the recording provisions of section 503 of the Federal Aviation Act. Included would be the various instruments executed for security purposes such as conveyances, leases, mortgages, equipment trusts, conditional sales contracts, etc. Assignments, amendments, and supplements to such instruments would similarly be covered. To determine the validity of such an instrument, one would need only to look to the substantive law of the particular State in which the relevant instrument was delivered.

The fact that the determination of the validity of aircraft conveyances involved extremely cumbersome and complex procedures was recognized by the Congress when it originally enacted the Civil Aeronautics Act of 1938. That act contained a provision which provided for the establishment of a central national recording system for all instruments affecting title to or interest in civil aircraft of this country. This provision was incorporated in section 503 of the Federal Aviation Act of 1958 substantially without change. It continued the previously established recording system and provides that no conveyance or instrument affecting aircraft shall be valid until filed for recordation except as to the parties to the instrument or persons with actual knowledge of its existence. When the instrument has been filed for recordation under the law, all persons are deemed to have notice of its existence and its effect on title to the property covered thereby. Consequently, to determine whether there are any encumbrances on the aircraft, it is only necessary to consult the central file.

While existing law has assisted materially in facilitating the determination as to the validity of instruments, it does not establish the substantive validity of the instrument as proposed by this measure. Considerable doubt and confusion still exist in this field. The laws of the various States differ quite substantially with respect to the validity of various instruments. In attempting to resolve the issue as to which jurisdiction's laws should apply in determining such an instrument's validity, it is arguable that the law of one of three of the following jurisdictions is applicable: The jurisdiction in which the property is located; the jurisdiction in which the parties reside; or the jurisdiction in which the instrument was executed and delivered. As an example of the needless complexities and difficulties in making such a determination, suppose an airline desired to refinance its fleet of aircraft: each of the three rules governing jurisdiction would have to be covered. With respect

to the first, for example, it would be necessary to know the exact location of every aircraft at the precise moment the refinancing instrument was executed. Pinpointing the exact location of aircraft, many of which today fly at speeds well in excess of 500 miles an hour, is extremely difficult and at times impossible. Such unnecessary and costly procedures which one must now go through to determine the validity of aircraft instruments would be remedied by this legislation. The bill selects, and the committee is convinced, most logically, the place where the instrument is delivered. Consequently, the prospective purchaser would not only be able to readily ascertain whether encumbrances are recorded against an aircraft but would in addition be in the position to assess the validity of any instruments affecting the aircraft's title by simply consulting the law of the place where the instruments were delivered.

The bill also amends section 503(e) of the Federal Aviation Act which provides that no instrument shall be recorded unless acknowledged before a notary public. This acknowledgment requirement is unnecessarily burdensome and directed to no useful end when applied to certain conveyances and instruments which do not normally depend for validity upon acknowledgement to establish their authenticity. This would include various governmentally issued documents such as judicial decrees. Certified copies of these official records are presently admissible in the courts to determine private rights by virture of rule 44 of the Federal Rules of Civil Procedure. Consequently, more stringent proof of authenticity is unnecessary. The committee is advised that the Federal Aviation Agency has received numerous complaints from various private citizens and Government officials to the effect that this procedure is cumbersome and unnecessary. The Agency, of course, was not in a position to remedy the situation since the procedure is specifically required by statute. Since no useful purpose is served by requiring the inclusion of certain

instruments in section 503(e) the bill authorizes the Administrator of the Federal Aviation Agency to except such instruments by regulation.

TAX LIEN PROPOSAL

The Internal Revenue Code (26 U.S.C. 6321, 6323) provides that notices of Federal tax liens shall be filed with the U.S. district court or the office provided by State law in the jurisdiction where the taxpayer's property is located. The Internal Revenue Service has, as a matter of practice, only filed its notices of tax liens locally and not with the Federal Aviation Agency. It has been contended by some that the Federal Aviation Act requires the Service to file tax liens with the Federal Aviation Agency. In order to clarify this point, the Treasury Department proposed that the committee adopt in this bill an amendment to the Federal Aviation Act to specifically exclude tax liens from the recording provisions. The Air Transport Association, together with several airlines, strongly objected to the proposed amendment and expressed the view that it should be made the subject of separate hearings. While the committee appreciates the desire of the Internal Revenue Service to settle, by means of substantive legislation, the tax lien question, and agrees that this bill provides an appropriate vehicle for its resolution, the latter is extraneous to the basic objective of this legislation, viz., the establishment of a uniform Federal rule governing the validity of aircraft conveyances. Since the bill, without the amendment, is noncontroversial and provides a highly desirable clarification of law, the committee determined that it should be passed without delay. In so doing, the committee wishes to make unequivocally clear that its action should not in any way be interpreted as a judgment that the tax lien proposal either is or is not desirable or as a reflection on the validity of the arguments advanced in support thereof by the Treasury Department. The committee is simply deferring its decision in order to afford all interested parties the opportunity to fully express their views in open hearings in the near future.

CONCLUSION

The purpose of the bill is directed toward the unnecessary ambiguity, complexity, and time-consuming procedures involved in determining the validity of aircraft conveyances. Passage of this measure will minimize these problems and greatly facilitate the ease by which aircraft can be financed. The committee is convinced of the need for this legislation and accordingly urges its favorable consideration.

COST OF THE LEGISLATION

There will be no additional cost incurred by the Government as a result of favorable action on this legislation.

AGENCY COMMENTS

The Department of Justice had no comment to make on this bill.

The following written reports were received from Government agencies:

CIVIL AERONAUTICS BOARD,
Washington, D. C., January 14, 1964.

HON. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate, Washington, D. C.

DEAR MR. CHAIRMAN: This is in reply to your letter of January 7, 1964, requesting the views of the Board with respect to H.R. 8673, an act to amend title V of the Federal Aviation Act of 1958 to provide that the validity of an instrument the recording of which is provided for by such act shall be governed

by the laws of the place in which such instrument is delivered, and for other purposes.

The provisions of the bill would not affect the functions and activities of the Board, but rather involve matters which are the responsibility of the Administrator of the Federal Aviation Agency. In these circumstances, the Board does not have any comments to offer with respect to the bill.

Sincerely yours,

ALAN S. BOYD,
Acting Chairman

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, January 17, 1964.

B-148101.
HON. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U. S. Senate.

DEAR MR. CHAIRMAN: Further reference is made to your letter of January 7, 1964, acknowledged on January 8, requesting the comments of the General Accounting Office concerning H.R. 8673, 88th Congress, 1st session, entitled "An act to amend title V of the Federal Aviation Act of 1958 to provide that the validity of an instrument the recording of which is provided for by such act shall be governed by the laws of the place in which such instrument is delivered, and for other purposes."

We have no special information or knowledge as to the desirability of the proposed legislation and, therefore, we make no recommendation with respect to its enactment.

Sincerely yours,

JOSEPH CAMPBELL,
Comptroller General of the United States.

FEDERAL AVIATION AGENCY,
Washington, D. C., January 17, 1964.

HON. WARREN G. MAGNUSON,
Chairman Committee on Commerce,
U. S. Senate, Washington, D. C.

DEAR MR. CHAIRMAN: This is in reply to your request of January 7, 1964, for the views of this Agency with respect to H.R. 8673, an act to amend title V of the Federal Aviation Act of 1958 to provide that the validity of an instrument the recording of which is provided for by such act shall be governed by the laws of the place in which such instrument is delivered, and for other purposes.

Title V of the Federal Aviation Act establishes a central recording system for all instruments affecting title to or interest in civil aircraft of the United States. Section 503 provides that no conveyance or instrument affecting title to an aircraft shall be valid until filed for recordation, except as to parties to the instrument or those with actual notice of its existence.

While recordation does afford notice to the world of the existence of an instrument affecting title, it does not purport to establish the substantive validity of the instrument. As is the case with other recording systems, substantive validity of a recorded instrument remains a question of local law. Determining which local law applies to the instruments is extremely difficult, however, when one is dealing with highly mobile property such as aircraft. In the existing state of law, therefore, the parties executing an instrument affecting aircraft, or prospective purchasers of aircraft seeking to determine the validity of encumbrances recorded against the property may be faced with considerable uncertainty as to the State law applicable.

Section 1 of H.R. 8673 has as its sole purpose the identification of the local law which will govern the validity of recorded

instruments. It selects, we believe logically, the law of the place where the instrument was delivered. Thus, the prospective purchaser who finds an outstanding mortgage recorded against an aircraft will, by consulting the law of the place where the mortgage was delivered, be in a position to assess its validity. Likewise, the parties to a mortgage need only to conform their instrument to the law of the intended place of delivery to insure its validity.

We believe H.R. 8673 has been carefully tailored to meet the precise problem presented, and we are in favor of its enactment. It will not interfere with our administration of the recording system and promises to increase the utility and effectiveness of that system.

Sections 2 of H.R. 8673 amends present section 503(e) of the Federal Aviation Act of 1958, which requires that "no conveyance or other instrument shall be recorded unless it shall have been acknowledged before a notary public or other officer authorized by the law of the United States, or of a State, Territory, or possession thereof, or the District of Columbia, to take acknowledgement of deeds." This requirement is unnecessarily burdensome and directed to no useful end when applied to certain conveyances or instruments of title which are not normally and do not depend for validity upon being acknowledged before a notary public to establish their authenticity, for example governmentally issued documents such as judicial decrees. Under rule 44 of the Federal Rules of Civil Procedure, properly certified copies of these official records are admissible in courts of law to determine private rights. It seems unnecessary to require more stringent proof of authenticity for recording purposes.

The Agency has engaged in a good deal of correspondence regarding this requirement with both citizens and Government officials to all of whom the procedure seems cumbersome and

unnecessary. We have had to take the position in replying to this correspondence that section 503(e) of the act, as presently worded, leaves us no choice in the matter. We believe the recording system could be administered more efficiently and simply if we had that choice. We therefore recommended to the House Committee that section 503(e) of the Federal Aviation Act of 1958 be amended to permit the Administrator of the Federal Aviation Agency to determine what instruments or conveyances must be so acknowledged before recordation. We suggested that this could be accomplished by inserting the phrase "Except as the Administrator may by regulation prescribe," as the introductory phrase to the sentence now serving as section 503(e) of the Federal Aviation Act of 1958. Section 2 of H.R. 8673 incorporates this recommendation and we favor its enactment. The Bureau of the Budget has advised that there is no objection from the standpoint of the administration's program to the submission of this report to your committee.

Sincerely,

N. E. HALABY, *Administrator.*

GENERAL COUNSEL OF THE DEPARTMENT OF COMMERCE,
Washington, D. C., March 25, 1964.

HON. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U. S. Senate,
Washington, D. C.

DEAR MR. CHAIRMAN: This is in further reply to your request for the views of this Department concerning H.R. 8673, an act to amend title V of the Federal Aviation Act of 1958 to

provide that the validity of an instrument the recording of which is provided for by such act shall be governed by the laws of the place in which such instrument is delivered, and for other purposes.

The principal purpose of H.R. 8673 is to amend title V of the Federal Aviation Act of 1958 by adding a new section providing that the validity of any credit instrument affecting title to or interest in civil aircraft and related equipment, the recording of which is provided for under section 503 of the act, shall be governed by the laws of the place in which such instrument is delivered.

At present there is no certainty with respect to the validity of credit instruments affecting civil aircraft and related equipment. Each State has its own requirements concerning the recordation of credit instruments and the validity of contracts executed in other jurisdictions.

H.R. 8673 would tend to encourage lending institutions to extend credit to the aviation industry by establishing certainty as to the validity of credit instruments secured by aircraft, and by reducing the costs incident to multiple filing and enforcing liens under the present system.

This Department, therefore, recommends enactment of H.R. 8673.

We have been advised by the Bureau of the Budget that there would be no objection to the submission of our report from the standpoint of the administration's program.

Sincerely,

ROBERT E. GILES.

THE GENERAL COUNSEL OF THE TREASURY
Washington, D. C., February 28, 1964.

HON. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U. S. Senate, Washington, D. C.

DEAR MR. CHAIRMAN: Reference is made to your request for the views of this Department on H.R. 8673, to amend title V of the Federal Aviation Act of 1958 to provide that the validity of an instrument the recording of which is provided for by such act shall be governed by the laws of the place in which such instrument is delivered, and for other purposes, and an amendment adopted by your committee to the bill.

H.R. 8673 would add new section 506 to the Federal Aviation Act to provide that the validity of any instrument the recording of which is provided for by section 503 of such act shall be governed by the laws of the State, District of Columbia, territory, or possession of the United States wherein it is delivered. The bill would also amend section 503 of the act to authorize the Administrator of the Federal Aviation Agency to except certain instruments from the necessity of having to be notarized before recordation. The amendment adopted by your committee would provide as follows:

> "Sec.---. Section 503(a) of the Federal Aviation Act of 1958 is amended by adding thereto the following new subsection:
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> "'---. Any tax lien arising under the internal revenue laws of the United States, the District of Columbia, any State of the United States or any political subdivision thereof, and the possessions of the United States, are specifically excluded from the recording provisions of this section.'"

Under the present act the term "conveyance" is defined in section 101(17) as including "any instrument affecting title to, or interest in, property." The regulations of the Federal Aviation Agency (14 CFR 503.2(a)) provide that the term "conveyance" includes a "notice of tax lien." The regulations of the Agency further provide that to be eligible for recordation a conveyance must describe the aircraft, propellers, or spare parts affected by the conveyance or lien.

The regulations of the Federal Aviation Agency are considered to be inconsistent with the provisions of sections 6321 and 6323 of the Internal Revenue Code and the regulations prescribed thereunder (26 CFR 301.6321-1, 301.6323-1). The Federal tax lien is a general lien attaching to all property and rights to property belonging to the taxpayer and the notice of the lien is not required to describe the property to which it attaches, nor is it required that the notice be filed in specific offices to cover individual pieces of a taxpayer's property. Notices of tax liens are filed in the offices designated by the States in which property subject to the lien is located, or, if the State has not by law designated an office for the filing of notices of tax liens, they are filed in the office of the clerk of the U.S. district court for the judicial district in which the property subject to the lien is situated. Notices of tax liens to cover all personal property are filed in a designated office where the taxpayer is domiciled.

The filing of the notice of Federal tax lien as prescribed by section 6323 of the Internal Revenue Code is a time-honored procedure which has been upheld by the courts over the years cf., *United States v. Union Central Life Insurance Company* (1961) 368 U.S. 291. Any law which could be interpreted to require that the notice of tax lien enumerate the specific property to which it attaches would create confusion where none should exist. Thus, the enactment of H.R. 8673 without your committee's amendment specifically excluding all Federal, State, and local tax

liens from the recordation provisions of the Federal Aviation Act would lead to further confusion and ambiguity.

The Department submitted a report along the same lines as set forth herein on S. 475 (88th Cong., 1st sess.), a bill which would have accomplished the same purposes as H.R. 8673 and which was similar to S. 2773 (87th Cong., 2d sess.). Your committee in its Report No. 1995 to accompany S. 2773 made the following comments:

"The problems in recording notices of tax liens prove particularly troublesome, since the Internal Revenue Code (26 U.S.C. 6321, 6323) provides that notices of Federal tax liens shall be filed with the U.S. district court, or the office provided by State law in the jurisdiction where the taxpayer's property is located. The Internal Revenue Service has, as a matter of practice, only filed its notices of tax liens locally and not with the Federal Aviation Agency. Accordingly, a purchaser in examining the central filing system maintained by the Agency could easily be misled in assuming that the absence of tax lien notices in the Agency's file meant that no such lien existed. To remedy this situation, two alternative solutions are presented: An amendment to the Federal Aviation Act to exclude tax liens from the recording provisions or an amendment to the Internal Revenue Code requiring that Federal tax liens must be filed with the Federal Aviation Agency. Your committee is convinced that an amendment to the Federal Aviation Act is clearly the most practical and logical choice. A Federal tax lien is a general charge on all real and personal property of a delinquent taxpayer and does not describe specific property. Consequently the Internal Revenue Service would have no practical means of ascertaining which of the many delinquent taxpayers owned aircraft. It would have to either file every tax lien with the Agency or be required to make a most needless and time-consuming search of the Agency's aircraft registration records. In addition, since a lien is a charge on after-acquired property,

effective operation of the recording system would require that all new applicants for aircraft registration certificates be checked against the current delinquent list in order that existing liens could be recorded against the newly acquired aircraft. There is also the possibility that in creating an exception for aircraft to the general scheme of tax enforcement, questions would be raised regarding the sufficiency of local notices of tax liens against other forms of property."

The Department concurs with the views expressed in the foregoing report and if H.R. 8673 is amended as recommended by your committee the Department would have no objection to its enactment. Otherwise, the Department would be strongly opposed to the proposed legislation.

The Department has been previously advised by the Bureau of the Budget that there was no objection from the standpoint of the administration's program to the submission of a similar report on S. 475, a similar bill.

Sincerely yours,

G. D'ANDELOT BELIN,
General Counsel.